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Business this week

Mar 8th 2001
From The Economist print edition

Daft decision

EPA

Coca-Cola, a soft-drink giant that has lost much of its fizz in recent years, announced a management reorganisation. Jack Stahl, second-in-command behind Douglas Daft, resigned amid rumours that he and his boss did not always see eye to eye. He will not be replaced; the company will be run as four separate units each directly reporting to Mr Daft.

See article: Shaking up Coca-Cola

Tim Koogle stepped down as CEO of **Yahoo!** but said he would remain as chairman. The company warned that first-quarter earnings and revenues would be less than the market's already lowered expectations. The slump in online advertising is to blame.

Also emphasising a fall in advertising revenues, **Dow Jones** sharply cut its forecast of first-quarter earnings and said it would reduce its payroll. This followed gloomy statements, along similar lines, from the New York Times company and Knight Ridder.

Merck, a top American drug company, said that it would slash the price of AIDS drugs to developing countries, forgoing any profit from the sales. Other drug companies are likely to follow suit. The world's leading drug companies are currently suing South Africa's government over its plans to circumvent the patents on their products.

See article: Drugs, patents and AIDS

American Airlines faced last-minute competition to its lone bid for **TWA**, an airline in the bankruptcy courts. A group led by Carl Icahn, an American financier, said it would pay $650m for the airline, trumping AA's $500m.

Mitsubishi Motors, a Japanese car firm 34% owned by DaimlerChrysler, warned that losses would be even more severe than expected, at ¥250 billion ($2.09 billion). DaimlerChrysler started talks with Volvo about buying the Swedish firm's stake in Mitsubishi.

Royal Dutch/Shell launched a bid worth $2.2 billion for **Barrett Resources**, an American natural-gas company. It also bought the energy interests of Fletcher Challenge, a New Zealand firm, for NZ$4.9 billion ($2.1 billion) after a long takeover battle.

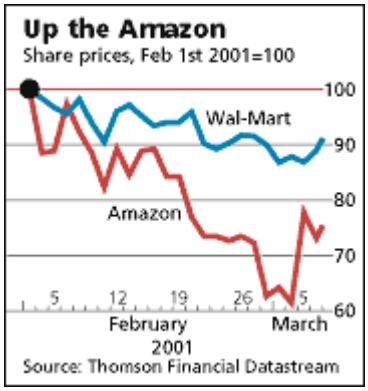
Can stop the music

In a comprehensive victory for the recording industry, an American court ordered **Napster**, a free service for downloading music from the Internet, to begin blocking access to copyrighted material. Record companies and music publishers will submit lists of the many thousands of tunes that Napster must stop offering on its system.

See article: Face value: Thomas Middelhoff, Napster's music-industry ally

Shares in **Amazon**, a leading online retailer, shot up by 26% in one day after rumours of a possible alliance with **Wal-Mart**, the world's largest

offline retailer. However, Amazon's shares slid back after further hints that a tie-up was not imminent.



Japan Telecom joined a growing list of telecoms companies that have announced a delay to the roll-out of third-generation mobile services; customers will have to wait a further six months until July 2002. J-Phone, Japan Telecom's mobile unit, estimates that it will spend ¥700 billion ($5.86 billion) over three years to construct its 3G network.

France Telecom announced the biggest-ever corporate bond issue, worth over $16 billion, beating Deutsche Telekom's $14.6 billion issue last year. The company will use the money to refinance recent acquisitions.

Four of America's **top chip makers**—LSI Logic, Cypress, Vitesse and Xilinx—issued profit warnings as sales of semiconductors continued to disappoint. The Semiconductor Industry Association predicted no upturn until the last quarter of this year.

New.net, a company backed by Idealab!, a dotcom incubator, launched a challenge to ICANN, a non-profit organisation that has a monopoly over the Internet's address system. New.net will sell domain names based on suffixes that are not sanctioned by ICANN including .kids, .family and the possibly less wholesome .xxx.

See article: ICANN's unwelcome rival

Tip of the bulge

Goldman Sachs announced plans to beef up its fund-management business. It hopes to have $1 trillion under management within five years. The bank wants a large slice of business from the super-rich—the world's billionaires, said to control $2.4 trillion.

Deutsche Bank was reported to be in talks with **AXA**, a giant French insurance group with interests in Germany. Deutsche is keen to link up with a heavyweight insurance company to pursue a Europewide *bancassurance* strategy and has talked to several other insurers including Germany's largest, Allianz.

Sliding

The **yen** fell to its lowest since July 1999, dipping below ¥120 to the dollar after Japan's government noted that a weaker currency would help exports. The finance minister, Kiichi Miyazawa, then made the surprising, if plausible, claim that his public finances were close to collapse.

See article: Drift in Japan

Wim Duisenberg, president of the **European Central Bank**, said that EU enlargement may require rotating membership of the bank's 18-man policymaking committee. The change would need unanimous approval by the leaders of EU member countries.

Euroland's GDP rose by 0.7% quarter-on-quarter in the last three months of 2000. The region's year-on-year rate of growth fell slightly from 3.2% in the third quarter to 3.0% in the fourth. **Germany** continues to languish. Its unemployment rose fractionally in February (though not enough to change the rate, which remained at 9.3% of the workforce) and manufacturing orders fell by 3.9% in January.

Correction:

Last week we said that AT&T sold its cable division, AT&T Broadband. In fact, it has disposed of only a small part of the division; AT&T Broadband remains part of AT&T.

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The world this week

Mar 8th 2001
From The Economist print edition

Sharon's coalition

AP

Ariel Sharon, **Israel**'s new right-wing prime minister, formed a broad-based coalition commanding 78 seats in the 120-member Knesset. Mr Sharon committed himself to negotiate with the Palestinians, but not while violence continued. His 26-member cabinet includes the Labour veteran, Shimon Peres, as foreign minister.

See article: Sharon's new government

A stampede caused the death of 23 women and 12 men during the annual **Hajj** pilgrimage to Mecca. Saudi Arabia's interior minister put the blame both on his own country and on foreign organisers.

The UN Security Council banned diamond sales from **Liberia**, which stands accused of helping Sierra Leonean rebels. The ban is delayed for two months to see if Liberia honours its own anti-smuggling commitment.

Having declared he would not yield to political pressure to force him out of office, **Zimbawe**'s chief justice, Anthony Gubbay, was eventually driven to resign by threats.

See article: Mugabe visits Europe

A new president, Pedro Pires, was peacefully elected in **Cape Verde**.

Security guards shot and killed supporters of an opposition candidate as voters prepared for the presidential election in **Uganda**, postponed until March 12th. Complaints of arbitrary arrest and intimidation grew as opinion polls suggested that President Yoweri Museveni might be run close in the vote.

In Kenya, several hundred refugees who had fled violence in **Zanzibar** began a hunger strike in protest at their treatment by Kenya's authorities.

Well defended

China said it would spend $17 billion on defence in the coming 12 months, an increase of nearly 18%. The United States said it was "concerned" and would continue to sell Taiwan enough weapons to defend itself.

See article: China's increase in defence spending

An explosion in a school in Fanglin, in eastern **China**, killed 41 people, many of them children. The blast was blamed by local people on an accident with fireworks being made by the children to raise money for the school. China's government denied this.

President Kim Dae Jung of South Korea and President George Bush conferred in Washington, DC, about future dealings with **North Korea**. Mr Bush talked tough.

See article: South Korea's Kim meets George Bush

A bomb destroyed an aircraft at Bangkok airport waiting to take **Thailand**'s prime minister, Thaksin Shinawatra, on a trip to the northern city of Chiang Mai.

AP

The Taliban said that its plan to destroy two huge and ancient statues of Buddha was "irreversible". **Afghanistan**'s Islamic fundamentalist rulers were condemned by governments around the world for the decision.

See article: The iconoclasts of Afghanistan

President Abdurrahman Wahid of **Indonesia** returned home from a pilgrimage to Mecca to be met by protesters demanding his resignation for failing to end the country's ethnic violence.

Border clashes

Macedonian troops clashed with ethnic-Albanian guerrillas near the **Kosovo** border, after a landmine killed two Macedonian soldiers and a sniper a third. In **Bosnia**, the UN sacked the Croat member of the three-man presidency, Ante Jelavic, for working for a separate Croat government.

See article: Macedonia near the brink of battle

The collapse of a bridge over **Portugal**'s river Douro killed some 70 bus and car passengers. Next shock: Portugal's minister of public works promptly resigned.

Foot-and-mouth disease spread across Britain's farms and national parks, and panic about it across Europe. The EU suspended livestock markets. Italy banned imports of all animals susceptible to the disease. Horse races and rugby matches were cancelled.

Italy's parliament stood by for a dissolution in preparation for a general election, probably in May. **Britain**'s parliament heard a voter-wooing budget, for the same reason.

See article: A balanced budget

The EU reached agreement with **football** authorities over the transfer system. Though changed, it will survive.

Fed up with waiting for unions and employers to agree on reforms, **Spain**'s government decided to impose its own changes to the country's labour law. Firing of long-term employees will be cheaper, but those on short-term contracts will be eligible for severance pay.

See article: Spain's overdue labour reform

High finance

Apparently frustrated by his country's lack of economic progress, **Argentina**'s finance minister, Jose Luis Machinea, resigned. He was replaced by Ricardo Lopez Murphy, a conservative, whose main task will be to control government spending after a worrying surge in January.

See article: Argentina's fiscal nerves

Mario Covas, the governor of **Brazil**'s largest state, Sao Paulo, died of cancer. His death was a blow to President Fernando Henrique Cardoso's hopes of holding his coalition together.

Two students were shot dead at Santana High School, near **San Diego**, by a bullied classmate, and several others were wounded. President Bush resisted the temptation to discuss gun control.

The United States' vice-president, **Dick Cheney**, had another heart scare. He insisted that he would maintain his workload.

See article: Dick Cheney's tough morning

Reuters

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Waking up to equity risk

Mar 8th 2001
From The Economist print edition

Can the global equity culture survive its first bear market?

WE ASK all our readers to observe a one-minute silence on March 10th to mark the first anniversary of the Nasdaq peak. Over the past year this index, once the beacon of America's "new economy", has tumbled by 55%. America's broadest stockmarket index has lost more than 20% of its value. Markets around the world are now, on average, at least one-fifth below last year's peak, as share prices have also tumbled from Tokyo to Frankfurt, Sao Paulo to Seoul. Over the past year, around $4 trillion has been wiped off the value of American shares alone, a sum equivalent to 40% of the country's GDP. The collapse in share values after the stockmarket crash of 1987 was only half as big, at 20% of GDP. Welcome to the global bear market, the grizzliest for a generation.

Nowadays, falling share prices hurt economies more than they used to because stockmarkets are everywhere much bigger not just in absolute terms but also in relation to national income. As a result, America's economy may yet face a recession that was not supposed to happen (see article). But is even more at stake than the course of the business cycle in the United States and elsewhere? Might the fall in share prices spell the end of the public's passionate new fondness for equities? If so, that would be a more significant change than you might suppose.

The 1990s will be remembered as the start of the Internet age, but also the decade when the world—not just America—discovered shares. Global stockmarket capitalisation hit $35 trillion last year, 110% of global GDP, up from 40% in 1990. Stockmarkets used to be seen as the reserve of pinstriped brokers and their wealthy clients. No longer. Over half of all Americans now own shares, twice as many as on the eve of the 1987 crash. Share ownership is even higher in Australia, an economy which not so long ago was run by trade unions. In Germany, where cautious investors used to put their money in bonds, one-fifth of adults are now shareholders, twice as many as three years ago. Even poor countries, even communist ones—China is both—have become crazy for shares.

Wider share ownership is profoundly important. First and foremost, it spreads wealth. In addition, it changes attitudes towards economic freedom, by aligning workers' interests more closely with those of companies, so reducing opposition to lower business taxes or measures to make markets for goods and labour work better. Another aspect of the growing equity culture is greater shareholder activism. Continental Europe's new shareholders are putting pressure on managers to improve their performance. More than any one technological breakthrough, this cultural change promises to raise productivity and economic growth. (Indeed, it may even be a necessary condition for the rapid adoption of disruptive new technologies.) A thriving equity market makes it easier for young entrepreneurial firms to raise money. And it reduces the dependence of companies on bank credit—a notoriously hazardous and unstable way to allocate capital.

Will the slump in share prices kill this emerging equity culture? Plainly, it depends on how much worse, if at all, the share-price slump gets, and how quickly it is reversed. Share prices might recover as swiftly as after the crash of 1987. But by many traditional yardsticks they remain overvalued. And just as stockmarkets overshoot at the top, they often undershoot at the bottom.

Falling share prices have already dented enthusiasm for shares in Japan and many emerging markets. But after a pause, strong structural forces should continue to support the equity culture in the long term. In particular, as state pay-as-you-go pension schemes strain under the weight of ageing populations, governments around the world are keen to encourage a shift to private pensions. This will fatten the funds that invest in equities. After an 11-year bear market in Japan it is hardly surprising that less than 10% of households still own shares. Here, too, a rapidly ageing population poses a big challenge to pension finance. In the short term, on the other hand, a severe bear market would make it even harder to privatise state-run social-security systems, such as America's.

Grrr

Meanwhile, companies are struggling to cope. The supply of fresh equity capital has more or less dried up in America in recent months. This has had severe consequences further down America's capitalist food chain, because venture capitalists rely on the "exit route" of an IPO to get their money back (ideally multiplied many times over). Entrepreneurs with bright ideas are finding it hard to raise funds—a state of affairs that could do serious harm to prospects for further innovation. Small individual investors, especially, have lost some of their enthusiasm for equities. In America, "day trading" over the Internet is not the national pastime it was; these days it is regarded more as a mild form of mental illness. Actually, that is no bad thing. Small investors need to take a cautious long-term approach to the stockmarket.

With luck, the new equity culture will survive, but with added wisdom. The popularity of shares ought to reflect the underlying profitability of the companies that issue them, not delusions of instant riches at no risk. It ought to be guided too by something closer to intelligent analysis than the comments of one American dotcom analyst this week. Asked to explain why his recommended stocks were down 79% since the start of last year, he replied: "The market went from saying, 'We like companies that are growing quickly but are losing a lot of money,' to saying, 'We want to see earnings.' It's very hard to predict a 180-degree turn like that." Actually, it was dead easy to do so. Enough of a bear market to discredit the dispensers of such drivel can only be salutary.

Ups and downs aside, as long as there is a healthy supply of opportunities to make profits, the demand for shares should remain strong. If the bear market reminds "experts" and amateurs alike that risk and return go together, it will have served a useful purpose. And if, having done so, it then immediately goes away, that will be even better.

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An idea for Mr Bush

Mar 8th 2001
From The Economist print edition

George Bush has the power to turn his backyard, Washington, DC, into a national showcase for school vouchers. He should use it

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POLITICS, the practitioners so often say, is about compromise. There is no point, pragmatists insist through clouds of cigar smoke, in letting the best be the enemy of the good. Such noises, as understandable as they are disappointing, have been coming from George Bush about education.

School vouchers, which give parents the chance to choose where to spend their education money, will apparently have to be dropped from federal education reforms, in order to force through other improvements. That compromise, which would deprive poor parents of what looks like the best way to shake up America's lacklustre schools, is probably being accepted far too quickly, even on "pragmatic" grounds. But, even if Mr Bush gives in, there is still room for him to push through a smaller but eminently achievable reform—introducing vouchers in the District of Columbia.

Begin with the overall fudge. America's high schools, by most international standards, deliver terribly poor results. During the campaign, Mr Bush promised structural change, forcing teachers and schools to be more accountable. True to his word, his very first legislative proposal was to do with education, introducing more testing, more penalties for poor performance and, yes, a limited voucher plan.

Vouchers are not a magic bullet for America's schools. But the evidence from places like Milwaukee and Cleveland suggests they do help performance, and they do so not by destroying public schools, as the anti-voucher forces claim, but by forcing public schools to improve their performance. Ford's cars benefit from having Toyota as a competitor; Harvard's standards have not been lowered by the existence of Yale. If choice works for America's splendid universities, why not try it on those dreadful high schools?

The two main reasons offered are realpolitik and federalism. Democrats will probably support Mr Bush's plan, if he drops the bit that annoys the teachers' unions most; also, the federal government only contributes about 7% of the education budget, so most of the action happens at state level. Both are fair points. But there are still good reasons for wishing Mr Bush would put up more of a fight. Many Democratic constituencies—including poor blacks—seem keen on school choice. There is also surely room to use the bully pulpit of the presidency to trumpet the advantages of vouchers for individual states. And in one particular case—the District of Columbia—Mr Bush has no excuse for inaction.

Educating Washington

Washington, DC, is the epitome of what Mr Bush has himself called "the soft bigotry of low expectations". The most recent test figures (for 1998) show that 72% of DC's ten-year-olds read "below basic"—ie, they cannot read with understanding. This is a school district that deliberately starves its few good schools of resources in case they "suck talent" from the rest, and that cannot get rid of poor teachers even if it wants to. According to the new boss of the city's Board of Education, roughly half of the district's teachers are unqualified or incompetent. Unsurprisingly, poor local parents support using federal money to send their children to private and parochial schools. A third of eligible parents applied for private scholarships to send their children to fee-paying schools—even though it meant putting in up to $1,000 of their own.

Doing something about this involves a single phone call. The district is an administrative fief of the (currently Republican) Congress. In 1997 a cross-party quartet, led by Dick Armey, a Republican

congressman, and Joe Lieberman, a Democratic senator, introduced a bill which would have allowed almost 2,000 of the city's poorest children to attend private or parochial schools. It passed both the House and the Senate but was vetoed by President Clinton. Mr Bush should tell Mr Armey that he would sign a similar one.

Such a bill should delight even the most pragmatic Republican. What could be more compassionately conservative than fixing a school system where 80% of the pupils are black? And what could be more embarrassing to Democrats than having to explain why they send their own children to fancy private schools while denying poor blacks similar choices? Few people notice the excellent results being achieved in Milwaukee and Cleveland. But if Mr Bush creates a voucher programme in Washington, DC, the whole world will know.

There are few occasions when political self-interest and enlightened policymaking coincide quite so neatly. President Bush should get on the phone to Mr Armey immediately.

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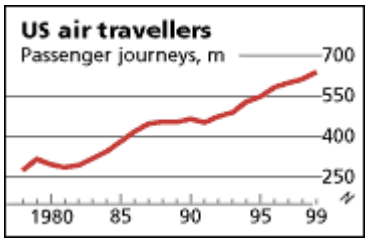
Fixing America's airlines

Mar 8th 2001
From The Economist print edition

Air travel in America is in crisis. The answer is not re-regulation

IF YOU are reading this in mid-air over America and the cabin starts to tilt down suddenly, don't be surprised: you are just experiencing an "unstabilised approach". This is pilot-speak for when an aircraft has to swoop swiftly down to land, because a normal, unhurried (and inherently safer) descent would mean missing a scarce landing slot. At least one leading American airline has noticed a 30% rise in such landings during the past six months, mostly over California, as America's skies become more crowded and its creaking air-traffic-control system fails to cope.



Delays and frustration caused by air-traffic problems, airline incompetence or bolshie pilots have hit not just the road warriors of business but the millions of ordinary people visiting relatives or flying to enjoy a spot of winter sun. Congressmen are surfing this wave of dissatisfaction. Their demagogue's response is to call for re-regulation of an industry which led the world in liberalisation over 20 years ago.

The first thing to understand about improving air travel in America is that moving back towards the old regulated cartel, with flights, frequencies and fares set by bureaucrats, is not the answer. Aviation in America is a victim of its own success. At deregulation in 1978, there were 250m passengers a year; by last year that had nearly tripled to 670m, and the average fare was 40% lower in real terms. According to Leo Mullin, chief executive of Delta Airlines, the industry's problem is "crowds". Yet moaning about having too many customers is a long way short of an adequate response. Some fundamental problems in the structure of the industry itself need to be tackled to make liberalisation work properly.

The leading airlines are clear what the answer is: consolidation from six main carriers to three or four. United Airlines wants to take over US Airways while American Airlines wants to absorb bankrupt TWA and the bits of US Airways that United does not want. This would create two giants sharing half the market. There would then be great pressure on Delta to merge with Continental so that three mega-carriers would dominate the market, with other airlines miles behind.

The big carriers claim that consolidation would provide a smoother nationwide service. But a study by a congressional watchdog has found that there would be a clear reduction of competition on 657 routes, 13% of the total. That might not sound much, but United and US Airways between them already have more than half the market on 20% of the busiest routes. So, before the authorities approve any mergers, they should address barriers to competition and efficiency.

Push that tin

To manage today's crowded skies more effectively, air-traffic control should be privatised or at least made an independent, performance-driven agency rather than a part of the Department of Transportation, which is where it sits today in the Federal Aviation Authority (FAA). Decisions on new investment could then be taken faster and more logically, and it would be easier to raise the necessary capital. Regulatory oversight on matters of safety would remain the proper concern of the FAA.

Next, America's municipally owned airports should be turned into private concerns. They would probably remain local monopolies, but their dealings could then be subject to antitrust scrutiny. As our aviation survey in this issue explains, dominant airlines are able to shut out new entrants at their main hub airports by using their influence to stop expansion and by signing long, exclusive gate leases. These would be illegal if the airports were not municipally owned.

The simplest boost to competition would be to scrap the ancient law which forbids foreigners to own an American airline or to pick up passengers and fly them around the country. America forces "open skies" deals on many countries, while keeping its home market, which accounts for over a third of world air

travel, tightly closed. Among other American industries, only shipping enjoys such protection.

The merging airlines advocate the benefits of larger networks offering smoother transfer through hubs. They would, wouldn't they. Theoretically, other things equal, they are right: the larger the network the better, for both producer and consumer. But in the real world American travellers have seen the chaos caused by labour rows at three of the top six airlines in the past two years, and worry that fewer, bigger airlines would lead to bigger screw-ups.

In other network industries, such as telecoms, the big companies are "common carriers" obliged to offer access to competitors who can buy capacity on the network, and sell it on to consumers. The only way that happens in airlines is through old-fashioned bucket shops or their online Internet equivalents. The airlines dominate the former (choosing when to offload spare seats) and are seeking to rule the websites too. Instead they should be obliged to throw open their cabins, row by row, seat by seat to independent web retailers. That is the sort of regulation which boosts competition, not the kind that stifles it.

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Israel's odd couple

Mar 8th 2001
From The Economist print edition

Can Ariel Sharon and Shimon Peres restore Israelis' sense of personal security?

AP

SCRUPULOUS democracy is Israel's beacon in a bleak authoritarian desert. The results of all that voting are frequently bizarre: rotating prime ministerships, angry shoals of political minnows, mix-and-match coalitions that turn out to be unmanageable. But the latest government under Ariel Sharon, sworn in this week, is one of the oddest of the lot.

The vast collection of 26 incompatible ministers, with a dozen or so deputies, is held gingerly together by two old men, Mr Sharon, 73, and Shimon Peres, 77 (see article). The two share a historic past: they were both derring-do protégés of Ben-Gurion in Israel's early years, the one a soldier, the other a civilian. They now find themselves, largely by accident since both had been written off as party leaders, at the head of their respective right-wing and left-of-centre groupings. Mr Peres's job as foreign minister understates his importance. It was his eloquence, weighed against the scruples of conscience-bearing peaceniks, that persuaded most Labour members to support a national-unity government led by the veteran hawk who provoked the current Palestinian uprising—and which includes at least two members whose views break the far-right barrier of acceptability.

The government's "national unity" is born of an acknowledged national crisis. But there is no unity, in Israel or in its new government, on anything—except for a desire for security. Certainly, there is no unity on what a lasting peace with the Palestinians should be. The seven-year Oslo peace process is dead, and no one has plans for replacing it with a similarly long-term scheme. Instead, the Israelis, who almost unanimously blame Yasser Arafat for their troubles, face an embittered Palestinian population that feels itself still under occupation and sees no alternative but to fight for its rights. Mr Sharon won on a promise to give Israelis back their sense of security, to free them from the fear of Palestinian violence. And this is an aim that the government, disunited on everything else, will find it fairly easy to unite behind.

But regaining a freedom from fear will be much harder, certainly if repression is the favoured policy. Israel already stands accused of using excessive force against the Palestinians. And Mr Sharon's reputation for ruthlessness goes before him, which means that the world is watching him. Few therefore expect him to return to the calculated brutality with which, in his younger years, he responded to trouble.

Even so, his response to violence will be, at the least, attention-grabbing: he likes to try to finish things off, once and for all. Moreover, he is committed to pursue and punish Palestinian militancy. At the same time, he has promised to ease the harsh collective punishment of the rest of the population. The closed frontiers, road-blocks and no-go barriers of bulldozed land that seal, or attempt to seal, Israel and its far-flung settlements from the threat of terrorism have shut Palestinians into their towns and villages without jobs for themselves or markets for their produce. Yet the seal is not hermetic: the law-abiding may not be able to reach their doctors but the suicide-bombers may slip through to Israel's city centres.

If he is to keep his promise, Mr Sharon should lose no time in reconsidering the effectiveness, and the collateral damage, of the emergency arrangements that Colin Powell, America's secretary of state, last week denounced as Israel's "siege" of the territories. With the Palestinian Authority fast running out of money—UN officials talk of a financial collapse within the month—Mr Powell pointed to another sharp injustice: Israel is sitting on $50m in Palestinian tax revenues that it has collected. It should release those, at once.

Give, take and talk

The inevitable step, sooner or later, has to be negotiation of some kind. But Mr Sharon counts members

of Mr Arafat's own security forces among those he is fighting. And he has stressed, to general Israeli enthusiasm, that he will not negotiate even holding measures until the Palestinian leader publicly exhorts his people to call off the uprising. Mr Arafat, knowing how unpopular, and damaging to his own position, the response to such an unadorned exhortation would be, wants first to see the outlines of any possible measures.

It is partly a question of timing. The offer, though limited, could contain mild attractions: for instance, Palestinian statehood, which Mr Arafat once used as a threat, now holds no terrors for most Israelis, so long as the state is constrained in shape and function. Although the Palestinians officially reject any temporary agreement, striking a modest deal is not inconceivable. But if the new government concentrates exclusively on ending the violence through repression, the uprising will take longer to end, and will cost much blood. The hope must be that Mr Peres, the junior of the two old men in the coalition, is not there as a figleaf to mask Mr Sharon's hardline instincts, but as a friendly adviser, and one to be listened to.

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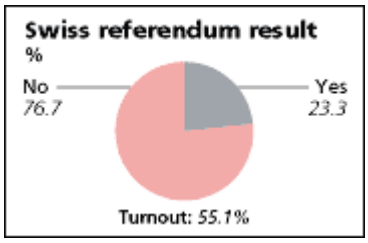
The Swiss say no

Mar 8th 2001
From The Economist print edition

In rejecting membership of the European Union, the Swiss have shown that political qualms can count for more than marginal economic arguments



SWITZERLAND is a paradox. Here is a small country surrounded by members of the European Union. Its citizens speak three main languages, none of them (at least as written) specifically Swiss. Of its 7m people, one-fifth come from outside. It lives off cross-border commerce, selling chemicals, machinery and precision instruments to the world, welcoming tourists and bank depositors from it. Swiss companies include such giant multinationals as Nestlé, Ciba-Geigy and ABB, itself born of a big cross-border merger. Many international bodies are headquartered in Switzerland: the Red Cross, sports bodies, bits of the United Nations. Yet the Swiss, traditionally neutral in war, have kept out of even the main peaceable cross-frontier organisations as well. They belong to the International Monetary Fund and the World Trade Organisation, for instance, but not yet to the UN. That may change after a referendum in 2002. But as for the far more restrictive bonds of the EU, no way: on Sunday, in a referendum calling for an immediate start to negotiations on EU membership, almost 77% of those who voted said no.

The call for a vote at all came only from dedicated Swiss Europhiles. The government and most politicians were against it, and so even were businessmen, essentially because they did not want a referendum which they knew would be lost. The government has been planning to start talks on membership at some (steadily receding) date from 2004, and wanted time to prepare Swiss institutions and practices— and, above all, public opinion. A premature vote could only hurt its plans, and has. Even the Europhiles did not really expect to win. But they did want to keep the issue on the front-burner. In the event, they were not just beaten but smashed, and the issue is off the stove itself.

Why? Why defy what look like solid economic arguments for getting inside the EU? After all, Switzerland already enjoys trade with the EU that is more or less free. The Swiss voted only last year in favour of a package of deals with the EU on various quite weighty matters. Over 70% of their trade is with EU countries, nearly all of them ones that will soon be using its new currency, the euro. Would it not be better to be on the inside of such a grouping, able to influence its decisions, rather than haggle with it, a small economic power with a huge one, from outside? And, equally, inside the euro-zone, and the European Central Bank? One could well think so.

One could, but the Swiss did not. There were short-term, immediate reasons, but the basic one is centuries old: the Swiss have forged and fought for their identity and independence since 1291, and they do not want to give it up. Not for nothing is their national myth-figure William Tell, a man who preferred to risk his son's life rather than accept foreign rule.

In any event, today's Swiss reckon that the economic case is less than compelling. They need free trade, but they can get it without being members of the EU, as the past 45 prosperous years have shown. They have no voice in Brussels, but they reckon they have not suffered unduly by bargaining from the outside. As for the euro, of course it is convenient to share a currency with your customers, but the Swiss have traded in umpteen foreign currencies since the gold standard. They can survive next-door to but outside the euro-zone, with no voice in its central bank, just as they have next-door to Germany's D-mark and with no voice in its Bundesbank: under pressure from a mighty currency, but still with some freedom to manage their own. In sum, they have most of the economic benefits of EU membership already, but none of the formal political constraints. The economic gains of joining would, at best, be modest; the psychological loss could be great.

The fact of independent-mindedness

The story does not stop at Switzerland. Canada has lived for 160 years next to a far larger economy, with

a different currency. Possibly Canadians would be richer if they were all Americans. Certainly they would carry more weight in Washington: think, for comparison, of California. Yet they prefer to be what they are, just as Irish republicans chose to cut loose from Britain in the 1920s, or as Norwegians voted against EU membership in 1994. And as most Britons, for similar reasons, would vote against euro membership today. The risks for Britain may be greater: it depends more than Switzerland does on foreign investors, and they might prefer to set up inside the euro-zone. But it is no good denouncing national feelings as mere tribalism. Such feelings may seem old-fashioned to some. But if people or nations feel that way, so be it. There is little evidence that most of them suffer thereby.

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The Afghan iconoclasts

Mar 8th 2001
From The Economist print edition

The appalling acts of an appalling, and increasingly isolated, regime

Reuters

IT IS depressing to observe that the world seems to care more about the destruction of two stone statues, which—let's be honest—hardly anyone had ever heard of until ten days ago, than about 100,000 refugees who have been starving and freezing to death near Herat a few hundred miles away from them. But human nature is such, and in ignoring it the Taliban, the brutal "Islamic students" who rule Afghanistan, appear to have shot themselves in both feet.

By announcing last week that, in the name of Islam, they would destroy two monumental Buddhas, dating back to between the second and fifth centuries AD, they have drawn more worldwide attention than have the regular massacres of their enemies, their appalling maltreatment of women and the savage punishments they mete out to petty criminals. Herat's refugees have been virtually ignored in comparison. And the fury has not been confined to the West: Islamic countries, including Pakistan, the Taliban's main ally, have joined in. They fear that iconoclasm on this scale—the larger of the two statues at Bamiyan is the tallest standing Buddha in the world—will discredit Islam in general, just as Hinduism has been tarnished by the destruction of the mosque at Ayodhya in the Indian state of Uttar Pradesh in 1992.

Some reports say that anti-aircraft fire has been turned against the statues. But Bamiyan is one of the world's most inaccessible places, particularly so since it became a battlefield in the war of attrition between the Taliban and the Northern Alliance that resists them from the small part of the country it still controls. So it is hard to know how badly the Buddhas are damaged. What is even more mysterious is why the Taliban have decided to pick a fight just now. Perhaps they just want to show that they are again firmly in control of Bamiyan, which they briefly lost earlier this year. It is more likely, though, that the statues are victims of the Taliban's rage at failing in their bid to win international acceptance.

A few months ago, the Taliban had seemed to be on an upswing. The Northern Alliance had been driven back to a mere toehold, and the view was increasingly heard that the West would soon have to accept that the Taliban were there to stay. There was talk of deals to drive pipelines through their territory from the Caspian Sea to the Indian Ocean. French officials, doubtless scenting contracts, started talks with the mullahs, arousing speculation that diplomatic recognition would eventually follow. The Taliban were also doing their bit to woo their many critics in the West, by cracking down on the cultivation of opium.

The wages of terror

Last October all that changed. A bomb attack on the *USS Cole* in Yemen left 17 Americans dead. The Americans are convinced that this, like the bombing of two of their African embassies in 1998, was the work of Osama bin Laden, a Saudi terrorist based in Afghanistan, which refuses to hand him over for trial. Instead of firing salvoes of missiles, as it ineffectually did in 1998, America opted to tighten the diplomatic and economic noose on Afghanistan. Mr bin Laden, and the Taliban, have infuriated Russia by helping the rebels in Chechnya and stirring up trouble in ex-Soviet Central Asia. They have annoyed the Chinese by opening similar links to Muslim separatists in China's western province of Xinjiang. America easily won Security Council approval last December for new sanctions severing Afghanistan's international air links and closing its embassies abroad, including the office it had maintained in New York to talk to the UN.

Damaging in their own right, these measures also signal the end of any hope the Taliban may have of normalising their relations with the outside world. The America-Russia-China coalition is now turning its weight towards supporting the Northern Alliance. By lashing out against the statues, and ignoring the entreaties of almost the entire world, the Taliban are revealing just how badly they have been hurt.

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Very flash, Gordon

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From The Economist print edition

Gordon Brown's budget has underlined Labour's strength ahead of Britain's general election

Get article background

YOU can forgive—well, just about—the front bench of Labour's government for looking so smug as they sat and listened to Gordon Brown delivering his final budget before the general election. You can even almost forgive the chancellor of the exchequer for sounding so insufferably pleased with himself. For this budget merely underlined the fact that, four years into its term in office, Labour is in a stronger position than anyone in the government can ever have dreamed of.

Inflation is lower, and more stable, than at any time since the early 1960s. Unemployment is higher than it was in those days, but is nevertheless at its lowest in 25 years and shows no sign of rising. Economic growth remains healthy, and even manufacturing exports have fared well despite a strong pound. The public finances are in a large surplus, so large that Mr Brown could claim (albeit with the chutzpah to ignore the effects of inflation) to have repaid more of the national debt in one year than all the previous governments did during the past 50 years. And so, just ahead of the election, Labour has the best of both worlds: it can claim credit for being a prudent proprietor over a stable economy, and can still hand out cash in tax cuts and new public-spending promises. What's more—oh, joy!—most of that cash went to families and to extra spending on health and education.

It is very likely that, had foot-and-mouth disease not intervened, Tony Blair would have followed Mr Brown's budget by almost immediately announcing that the election would be held on April 5th. But such a move, officially to get the election over with, unofficially to cash in on Labour's 20-point poll lead as quickly as possible, would have looked reckless while animals burned and people's movements in rural areas were being restricted. So the plan will probably now have switched back to the much-speculated-about date of May 3rd, with the election to be called in the last week of March, as long as the farming crisis has abated by then. And, although it is always hazardous to make forecasts ahead of the booby-trap-filled process of an election campaign, it is safe to say that it will be a huge surprise if Labour is not elected by another comfortable majority.

The economics and politics of a second term

That outcome would have been likely almost regardless of what Mr Brown said this week, but his measures will have plopped a bit more icing on the cake. As the Conservatives' leader, William Hague, showed, this was a hard budget to be in opposition against. As usual, Mr Brown could not resist offering meddling tax changes here, there and everywhere, but not enough to provide Mr Hague with any political traction. Moreover, no Tory could easily oppose more help for families with children, and the party has already said it would match whatever Labour plans to spend on health and education. If Mr Hague retains hopes of a miracle, it will not be on the basis of Labour's fiscal stance. But, for whoever is the Tory leader for the 2005 election, this budget might well have offered some more clues, and quite a lot more hope.

In terms of its fiscal stance, this budget is expansionary, but not recklessly so. On the Treasury's fairly cautious assumptions, the government's net borrowing will swing from a surplus of £16.4 billion ($23.8 billion) in the fiscal year just ending to a deficit of £11 billion in 2004-05, just before the next election but one. That is a big swing, but if the economy proves to be more affected by a global slowdown than Mr Brown predicts, it might offer a helpful stimulus. Although in a boom this could have led the Bank of England to keep interest rates high, it is unlikely to make much difference in slacker times.

Rather than in the pure macroeconomics of the fiscal stance, the significance of this budget is likely to lie in its composition. Labour began in 1997 with three years of astonishingly tight control of public spending

which it started, quite aggressively, to release last year. This budget has continued that trend, with an extra £650m a year for schools and hospitals. The first term, as Mr Brown might well say, was all about stability and competence. As it came to a close, however, the emphasis shifted towards public spending, and bringing about improvements in the public services. The second term will thus have to be all about delivery: about managing to spend the money, but also about proving that such spending—and such a large role for the state—is worthwhile.

So if, in its second term, Labour's economic luck were to run out, the option of battening down the hatches again on public spending would be hard to take. If anything, the pressure is going to be for the opposite, namely to buck the old trend by following pre-election prudence with post-election profligacy, in order to ensure that promises of better public services have a chance of being met. If a tightening were to be required, taxpayers would have to bear the burden.

That is all very theoretical. But what is practical is that the shift in Labour's spending stance last year, confirmed by this budget, has laid down the ideological shape of the next four years. Early on, the main political battleground may prove to be the euro. But the longer-term war will be about public spending: whether education and health care and other services can really be improved substantially by a mixture of money and exhortation, or whether deeper changes will be needed. Such clarity is not much help if you are a Tory facing defeat in a few weeks' time. But it might at least be a comfort.

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Letters

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From The Economist print edition

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Language barriers

SIR—English appears to be the logical language of choice in many parts of the world; except, ironically, America ("English is still on the march", February 24th). Bill Clinton, when president, signed an executive order requiring federal agencies to provide translation services to applicants in any language they choose (there are some 300 spoken here). The federally subsidised advocates of bilingual education in some areas are railroading all children with Hispanic surnames into bilingual (ie, Spanish) instruction, regardless of what the parents want.

I have found the French quite willing to speak English in their country after I have made an effort in their language first. The Germans have quite enough to worry about sorting out their newly mandated but widely unpopular *Rechtschreibung*. Denglish will happen, just as did Singlish in Singapore and pidgin English all over the Pacific in the second world war.

WALTER SPANGENBERG
LaConner, Washington

SIR—Monolingual Brits are too inclined to take the soft option, perhaps being unwilling or unable to cope with the rigours of learning another language. However, as increasing numbers of non-British Europeans perfect their knowledge of English they become freely able to use their skills to work in Britain (with the advantage of speaking their native language and often a third language). The monolingual British have few chances to work abroad and could become a second-rate choice in their own country.

ANTHONY LUNCH
Milston Manor, Northamptonshire

SIR—English actually comes from the continent. It is perhaps one of Germany's most successful exports; the later addition of French elements giving it a flavour of luxury. Why then should it not be Europe's *lingua franca*? Latin, of course, should be adopted as the second language.

MAARTEN WAELKENS
Sao Paulo

Down the Tube

SIR—On the disagreement between London's mayor, Ken Livingstone, and the Labour government over the future ownership and management structure of the London Underground, Bagehot (March 3rd) raises an issue that goes far beyond the underground itself. It is whether separation of railway infrastructure and operations can ever be successful. In my opinion it cannot. I served as the first chairman-CEO of Britain's largest rail-freight carrier after privatisation and was forced to deal with vertical separation while striving to improve customer service, reduce costs and manage a large rolling-stock investment programme. In every one of these areas, Railtrack was a major obstacle. In fact, Railtrack, and the management structure that came with it, was by a long way our largest problem.

More recently, safety, and economic and investment issues created by vertical separation, have caused huge problems on Britain's rail network and there is increasing disenchantment with the industry structure in place. Without huge government subsidies, vertical separation has been a failure everywhere it has been tried. It would be as disastrous for the London Underground to separate management between infrastructure and operations as it has been on the heavy-rail network. I am surprised that the Labour government has become so attached to the failed Tory model of functional separation.

EDWARD BURKHARDT
President, Rail World
Chicago

Democracy in Bahrain

SIR—The Bahrain National Charter deserves credit for intellectual content and good intentions ("Your kingdom for our rights", February 24th). I believe in the politics of small steps to achieve a desired goal. However, the "exit light" for the prime minister is not sufficient in itself to move events in the right direction. The whole administration is loaded with members of the Khalifa family and other appointees with vested interests.

Unless merit replaces incompetence, corruption and nepotism, the departure of one man will not deliver results. Bahrainis, especially the commercial, professional and intellectual elite, must contribute time and resources towards building a democratic society. Moreover, attracting foreign investors is not only a function of political stability but also of good governance by the civil service and the courts in the application of commercial law.

ABDUL RAHMAN AL-SA'I
London

Reagan's estate

SIR—You say "Ronald Reagan (who once made $2m for two 20-minute lectures in Japan) let some rich friends buy him a $2.5m house in Bel Air" ("Muddier yet", February 17th). Nancy Reagan recently confirmed that she and Mr Reagan borrowed the money for this purchase and have since repaid it with interest. She said that their money was in a blind trust at the time and they did not know how much they had. Of the $2m lectures, Mr Reagan asked, "what would you do?"

JOHN ELRICK
Monroeville, Pennsylvania

Unpopular populist

SIR—There was no major switch to Pauline Hanson's One Nation party in the state election in Queensland; they gained only around three seats out of a total of 89 ("Australia's populist bites back", February 24th). There was an unprecedented swing towards the centre-left Labor Party who held government prior to the election. It won 65 seats and crushed the opposing Liberal Party, which was reduced to just two seats.

Queensland as a whole does not want Mrs Hanson to gain any power. She represents ignorant redneck attitudes and the majority are well aware of this. I hope that this dangerous woman gains no more political ground and no more coverage by the media.

CHRIS DAVIS
Brisbane

No opposition

SIR—You are right to point out that the miserable opposition helps to keep Yoshiro Mori in power ("Being kind to Mr Mori", February 24th). Yukio Hatoyama is Japan's William Hague; neither are regarded as suitable prime ministers. Despite the view that neither will win the coming elections there is no momentum to oust either of them. Mr Hatoyama, unlike Mr Hague, completely lacks debating skills and does not have any allies, even in his own party.

Although the Democratic Party has a lot of brilliant young politicians, under the Japanese system it will take many years before they could become leaders. I am worried that Japan will sink before they come through, or that they will be institutionalised before they are allowed to come to the fore.

HIROYUKI MORITA
London

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CHINA'S ECONOMIC POWER

Enter the dragon

Mar 8th 2001 | BEIJING
From The Economist print edition

This is the first of a two-part series about China's rise, and its implications for the region and beyond. This week, we take a look at the mainland's economy, which is about to undergo some wrenching changes. Next week, we look at what China's rising power means for regional security

Get article background

ASK what has been the most stunning economic event of the past century, and many people might cite the case of China in the two decades since it opened up. In that time the economy has grown more than fivefold, incomes have quadrupled, and 270m Chinese have been lifted out of absolute poverty. Yet with a couple more decades' hindsight, that achievement might be superseded—by what may now be about to happen in the world's most populous country.

Much of China's growth up to now has been merely of a catch-up kind, as animal spirits were unleashed after agricultural communes were disbanded and restrictions on travel and informal enterprise were lifted. The government, in other words, did not have to do much except stand back. And for all the growth in the country's exports as China became a manufacturing colossus, only in 1993 did China's share of world trade reach its pre-1939 peak. Today, average income is a mere $950 a head, and the disparities in wealth are huge. China is still a poor country, in places abjectly so.

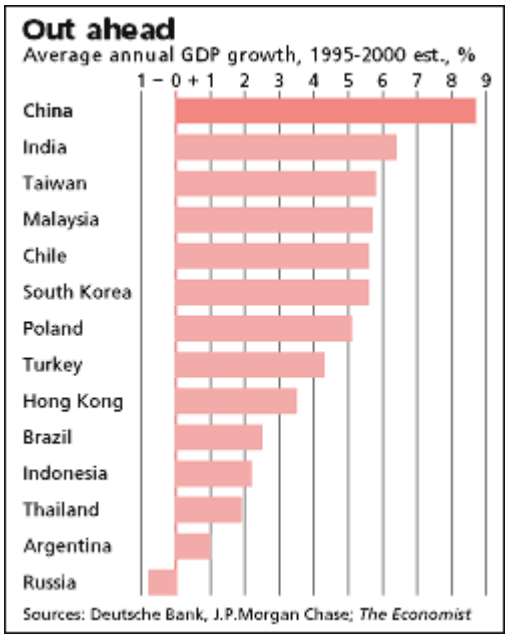
The coming two decades, on the other hand, offer the possibility of an even more extraordinary pace of economic change. These could be the decades when China truly joins the world, and when the crushing legacy of a socialist economy is swept away. China certainly has the potential, over this period, to become the second-largest economy in the world. Of course, that would not mean that all Chinese would grow rich. But China no doubt has the means to attain "middle income" status—putting the prosperity of its people, currently 1.3 billion souls, not far from South Korea or Portugal today. That would be an extraordinary feat for so large a population in so short a time. The geopolitical effects would also be immense.

A new taste for reform

This is the moment to contemplate such a future, because over the past year or so (and after seven years of falling growth) China's rulers have shown a determination to tackle the thorniest issues in the economy that they have never shown before. The most obvious symbols of that determination are the promises that were made, and the steps now being taken, to ensure that China is brought into the world

trading system. Nearly all the agreements are in place for China to join the World Trade Organisation (WTO) this year, after 15 years of trying. Over the next five years the country will slash tariff and non-tariff barriers, as well as open up sectors of the economy that have long been off-limits to foreigners, such as banking, telecoms and distribution. China promises to protect foreign intellectual property, and get rid of a raft of local-content requirements that have hobbled foreign manufacturers.

But WTO membership is just the first of the reform initiatives. The central government has declared war on most parts of the socialist economy, all the time insisting it is sticking to "the socialist road". It is bent on separating business from government, by getting rid of many smaller state enterprises and corporatising others. It wants to develop financial markets that bypass a decrepit state banking system and award capital to the deserving. It is building a national infrastructure of roads, railways and fibre-optic lines that promise for the first time in history to tie up the disparate parts of the Chinese empire, creating something like a unified economy.



The government is also encouraging new sources of domestic demand by privatising socialist housing (in the biggest cities, two-fifths of residents now own their own homes). It is trying to develop a clear and effective tax system, using information technology, it hopes, to monitor and crack down on local-government corruption. And it is attempting to patch together a set of social-welfare initiatives to catch the 5m-odd people being thrown out of work each year by state enterprises, as well as to provide pensions for an ageing population. Most of these ventures are politically fraught, and not for the faint-hearted. In his annual report to the National People's Congress this week, the prime minister, Zhu Rongji, promised more, not less, pain as reforms are redoubled: shutting down more loss-making enterprises, for instance, and selling others.

If the government makes good on all its promises, what assumptions can one make about future growth? First, note that assumptions are rosier if the government's own figures are used. Official growth statistics have long been exaggerated, for a number of reasons. For one, local officials cook the books to make their region look good. For another, China still produces goods that pile up as inventories and are never sold. Yet their production gets added to GDP, when it should be subtracted. The problem is that no one knows by quite how much official GDP is overstated. Last year's announced growth of 8% was perhaps one or two percentage points too high. At least the trend in GDP is fairly reliable, and at least the government is trying hard to improve the quality of its data. Over time, the figures should get more believable, not less.

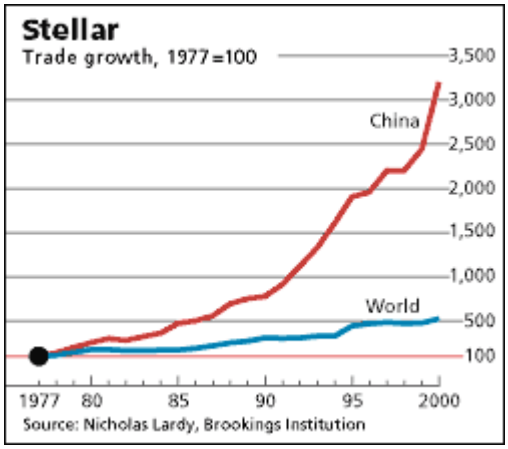
Andy Xie, an economist at Morgan Stanley in Hong Kong, reckons that if China sticks to its WTO commitments and, in effect, moves to a market-based economy by 2005, it will grow at 7% a year till 2005, then at 9% during 2006-15, as it reaps the benefits of restructuring, before slowing a bit thereafter. If so, by 2020, China's economy would have grown to $10 trillion in 2000 dollars, making it the size of America's economy today. Income per head will be $6,700. If China were to conform to global norms more quickly than the WTO framework demands—perhaps as a result of foreign pressure and trade tensions, or of domestic pressure to speed change along—then it would grow by 10% a year between 2006 and 2015, passing the $10 trillion mark by 2015. And if China's reforms run into the sand? More of that later.

A giant sucking sound

One of the immediate consequences of impending WTO membership is a swift increase in commitments of foreign direct investment (FDI): last year, committed FDI rose by over a third. Already, though, China's stock of FDI, at $350 billion, and growing by over $40 billion a year, is massive. It is the world's third-largest, behind America ($1.1 trillion) and Britain ($394 billion), and way ahead of countries like Brazil and Mexico that opened their markets much earlier than China. The mainland now accounts for about one-third of emerging markets' total stock of FDI, according to Nicholas Lardy of the Brookings Institution in Washington. Nearly four-fifths of all FDI going to South-East and East Asia, not counting Japan, is sucked up by China—and to its neighbours' growing alarm.

Traditionally, the bulk of FDI to China has gone into its export industries. Foreign trade has grown from almost nothing in the late 1970s to $475 billion last year, far faster than the growth in world trade as a whole (see chart). And foreign-invested firms have grown to account for half of all exports from China. Foreign investment has helped make China a formidable export machine. The country will no doubt continue to be one, thanks to a near-limitless pool of extraordinarily cheap labour, including a large and growing supply of educated graduates. Mainland computer engineers earn about one-tenth as much as their Taiwanese counterparts, and they are almost as good.

China's manufacturing is getting more sophisticated and employing more capital. Mr Xie argues that even as it moves up the manufacturing chain (eg, to semiconductors and to information-technology hardware, of which it is the world's third-biggest producer), China will not lose its advantages in cheap, labour-intensive areas such as toys, textiles and shoes. Without China's cost structures—that is, its economies of scale and its low standard of living—other exporters in the region, from Indonesia to South Korea, will have trouble staying in business: China can just about out-export them all.



This realisation comes as a profound shock to China's neighbours, most of whom have built a development strategy over the past few decades around export-led growth. It will soon come as a shock outside the region: to exporters in India, for instance, and Mexico, who thought themselves far removed from the Chinese threat. Indeed, Mexico has been very reluctant to sign up to China's entry to the WTO, and has been the final country to do so.

On the face of it, China's seems to be an export-driven economy, too. After all, annual exports are equivalent to at least 23% of GDP, making China the world's ninth-largest exporter. Even so, the brute figures conceal how imperfectly China's export sector is tied to its hinterland. Firms wholly or partly owned by foreigners account for about one-half of China's imports as well as its exports. Much export manufacturing, in other words, consists of processing industries that ship in components, bolt them together and ship them out again, often through Hong Kong. The foreign-dominated export sector, especially in China's handful of "special economic zones", should be thought of as an enclave, a giant version of the *maquiladoras* on the Mexican border with the United States. China, says Mr Lardy, is only shallowly integrated with the world economy.

Segregration carries costs. The technology and the management skills that foreign investment typically brings with it are not easily adopted by domestic firms. Meanwhile, economic growth is stifled within China by the dominance, in many sectors, of the state, by barriers to trade and local protectionism, and by the absence of proper capital markets. For Zhu Rongji and other reformers, WTO entry is important for its domestic consequences. Certainly, with its ability to export, China is a clear net beneficiary of the globalisation of trade. More important, though, is the fact that WTO membership will spur competition at home, acting as a rod to beat back the baneful influence of the state.

Goodbye, hermit China

The "price" that China pays for this is to allow foreigners in. It is the potential scale of China's domestic market, after its entry to the WTO, that most appeals to foreign multinationals. After decades, or rather centuries, of foreigners' dashed dreams about the money to be made from adding an inch to every Chinaman's shirt-tail, the promise that China has long held out may be about to be matched by reality.

Already, in unprotected sectors of the mainland economy, multinationals are a dominant force. Between them, McDonald's and Kentucky Fried Chicken have almost 700 branches. Kodak has half of the market for film and photographic paper, with Fuji holding most of the rest. Procter & Gamble is the biggest seller of shampoo, while foreign manufacturers, led by Motorola, Ericsson and Nokia, have 95% of the market for mobile phones, the world's biggest market in terms of handset sales. Coca-Cola says that China is about to become its biggest Asian market. Some estimates put foreign involvement at about one-tenth of the whole economy. With WTO membership, the proportion could easily double.

Yet China is not yet integrated into the world trading system, and it is no better integrated domestically. Think of China's potential not so much as an international trading economy, but as a vast "continental" one: a proto-America, as it were. Just as America's growth in the 19th century took off with the building

of the railways and of a national financial system, so China hopes to unify its hitherto fragmented, disjointed economy. Until recently, it took less time to ship a container from Shanghai to Seattle than from Shanghai to the inland city of Chongqing, 1,000 or so miles up the Yangzi river.

Just a dozen years ago, China had no highway system linking its provinces; now it has over 12,000km (7,500 miles) of such highways. The number of passenger flights has trebled in the past decade. There were 36m new subscribers for fixed-line telephones in 2000 alone, and 42m new mobile subscribers: fixed-line penetration, at 17% of households, grew 30-fold during the 1990s. Internet use, though still tiny, is more than doubling every year. China is integrating fast, and information technology is helping.

Financial integration also holds great promise. Until recently, the big four banks were captive lenders to state-owned enterprises. The state's share of the economy has fallen—to below half, according to some calculations—yet state-owned industries still control more than 70% of all fixed assets and 80% of all working capital in manufacturing, according to Mr Lardy of the Brookings Institution. The corollary is that private enterprise is stifled.

The government has bold plans to develop equity markets and to clean up the state banks. Already, debt-equity swaps have taken some 1.4 trillion yuan ($150 billion) of dud loans off the books of the banks, which have been ordered to lend in future only on merit. Equity markets have assumed a growing role in providing finance: 620 billion yuan last year, compared with 440 billion in 1999. The foreign portion of that grew nearly sevenfold, to 180 billion yuan. Shareholder discipline, at least in theory, should shape up management. Certainly, the flotations of some of the biggest Chinese companies that have recently come to market—Petrochina, China Mobile—were preceded by giant restructurings to make the companies look more like western ones.

Is the regime serious?

This raft of bold reforms has still to reach the other shore. Hopes in China have foundered before. This time, there will be proper ways to measure progress. China must successfully join the WTO, and stand by its commitments within it. It must continue to separate business from government, which eventually means getting the Communist Party out of both. The next step in this process is developing capital markets which reward good management and punish bad. A great deal more privatisation will be needed. Some analysts are sceptical about the chances of success. Stockmarket regulators, for instance, have announced sweeping initiatives, such as delisting money-losing companies, demanding more financial disclosure and setting up a second stockmarket for entrepreneurial companies. "But the rhetoric," says Mr Lardy, "is far in excess of the action."

Yet the regime is deadly serious about reform. It rests its legitimacy upon the goal of getting reform-driven growth, banishing Communist Party corruption along the way, and providing a safety net to catch the victims of wrenching change. Conservative ideologues have largely been beaten. When the current batch of Communist leaders steps down late next year, the new generation that will take its place should be much more cosmopolitan and reform-minded. If it is not, there is cause for worry. For the final measure of progress will be whether the leaders consider reform to the Communist Party's monopoly on power.

What are the economic implications abroad of a China resurgent? In the near term, China's growth promises to be a comfort for the region during a difficult time. Asia's exporters are concerned that America may be on the edge of a recession from which they would suffer grievously: after the Asian crisis of 1997-98, Asian economies counted upon strong American demand for their exports to pull them back from trouble.

China, on the other hand, will scarcely be affected. Jun Ma, an economist at Deutsche Bank in Hong Kong, estimates that even if China's net exports declined by a quarter this year (after growth of the same last year), a mere half-percentage point would be knocked off the country's growth. This reinforces the point that China's is a continental economy, driven by domestic demand.

It is possibly reassuring for China's neighbours to know that the giant would scarcely stir if the world economy turned down. Chinese imports grew by a staggering $55 billion last year, suggesting that the country is even becoming a regional engine of growth. But China's export threat to neighbouring economies underscores their predicament: in order to compete, they need to undertake much-postponed structural reforms themselves.

Longer-term, some groups in America will also see a resurgent Chinese economy as a threat. China's $60 billion trade surplus with the United States is already a bone of contention, while labour interests, among others, resent China joining the world. Many of the resentful ignore the fact that ties between the American and Chinese economies are already close, and multifaceted. Sales by American companies in China are now almost as large as American exports to China, while investment flows are every bit as important as trade flows. Shutting China out of the world would harm a lot of American interests. Moreover, as Mr Xie of Morgan Stanley emphasises, there is the prospect of some $40 trillion of new wealth over the next 15-20 years to be created by Chinese reforms, and foreigners are being offered a big share—perhaps one-fifth—of it.

These are the economic ties that increasingly bind China to its reforms and to the rest of the world. There are other, less formal ones. Some 50,000 Chinese study in American universities each year, for instance, and there are now even more American-educated Chinese than Soviet-educated ones. The ties are certainly more complex than they have ever been. They require a great deal more effort to manage. But they are surely safer for all that than few ties at all.

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Blacks v teachers

Mar 8th 2001 | WASHINGTON, DC
From The Economist print edition

Two of the Democrats' bedrock constituencies are heading for a fight over school choice

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THE presidential primary debates between Bill Bradley and Al Gore are little more than a historical footnote. But the debate last year in Harlem's Apollo Theatre, one of the holy places of black America, did include one exchange that will re-echo in Democratic politics in the coming years.

Tamela Edwards, a young black journalist, asked Vice-President Gore why he so adamantly opposed school vouchers, which allow parents to choose where to spend their education money, while sending his own children to private schools. "Is there not a public or charter school in DC good enough for your child?" she asked, to applause. "And, if not, why should the parents here have to keep their kids in public schools because they don't have the financial resources that you do?"

It is hardly surprising that this question resonated with the predominantly black audience. Last year, a national opinion poll conducted by the Joint Centre for Political and Economic Studies found that 57% of blacks support vouchers: especially people under 35 (75%) and people with children in the household (74%). Blacks and whites agreed that education is the most important problem facing the country. But blacks were more likely than whites to think that the public schools are getting worse—and more likely than whites to support vouchers.

The reason for this support is simple: blacks (who are disproportionately concentrated in inner-city areas) are getting a lousy deal from the public-school system. The National Assessment of Educational Progress, America's equivalent of a national report card, reveals that the average black 17-year-old is four years behind his white counterpart in maths and reading and five years behind in science. Black students are three times more likely than whites to be shunted off into dead-end special educational classes.

A majority of poor blacks have probably been in favour of vouchers for years. What is new is the growing willingness of black leaders to voice their feelings. A decade ago, only a handful were willing to support vouchers—notably Polly Williams, once a welfare mother in Milwaukee, Howard Fuller, a veteran of the black-power movement who helped Ms Williams to create the city's voucher programme, and Floyd Flake, a former Democratic congressman turned one-man urban regeneration machine. But two things are changing the balance of power.

The first is that pro-voucher blacks have established a lobbying group to plead their cause. The Black Alliance for Educational Options (BAEO) is only a few months old. But it attracted a boisterous crowd of more than 700 activists from 35 states at its recent symposium in Milwaukee, including teachers, religious and political leaders, and community activists such as the splendidly named Queen Sister Afrika of a group called We Are the Village People.

Phyllis Berry Myers, the director of the Centre for New Black Leadership, says that most of the people who turned up were "front-line warriors" who spend their lives dealing with the consequences of failing schools. The organisation's aim is to link the voucher movement with poor blacks, not rich whites (such as Tim Draper, a Silicon Valley businessman whose pro-voucher initiative failed miserably on the ballot in California last November). It is spending heavily on television advertisements that feature black parents and grandparents talking about the way that school choice has improved their children's lives.

The second change is the emergence of a younger generation of black leaders in their late 20s and 30s. Kaleem Caire, the head of BAEO, abandoned a career in educational administration to fight for vouchers because he thought that the system was short-changing poor black children. Cory Booker, who was educated at Stanford, Yale and Oxford (as a Rhodes scholar) before being elected to the Newark City

Council in 1998, argues that the only way to fix the educational system is to return power to parents. Omar Wasow, who runs a website called blackplanet.com, sees school choice as a direct outgrowth of *Brown v Board of Education*, the Supreme Court decision of 1954 that desegregated public schools.

For this generation, vouchers is the new civil-rights issue. “Did we sit down at a lunch counter at Woolworth’s in Greensboro, North Carolina,” Mr Fuller asks, referring to an anti-segregation protest in 1960, “to arrive at another lunch counter today where... we can’t read the menu?” Others refer to Malcolm X’s drive for black empowerment. Why shouldn’t poor people have the right to exercise a choice that their richer brethren take for granted?

These outspoken younger blacks are having an effect on the established black leadership. Andrew Young, Kurt Schmoke (a former mayor of Baltimore) and Martin Luther King III have all embraced vouchers. Meanwhile, a cadre of ambitious black politicians who would never have flirted with such a dangerous idea a few years ago now count themselves as supporters: politicians such as Marvin Pratt, the president of Milwaukee’s Common Council, who plans to run for mayor in 2002, and Dwight Evans, a Pennsylvania state legislator.

The hitch, of course, is that most old-style black leaders remain opposed. No black congressman has been willing to break with the teachers’ unions on the issue. The National Association for the Advancement of Coloured People also follows the teachers’ union line that vouchers will destroy the country’s public schools. Black teachers and administrators in urban school systems regard the idea as anathema. Urban school boards are huge political and financial machines: the Philadelphia school board, for example, has 25,000 employees and an annual budget of $1.6 billion.

Meanwhile, the voucher movement is internally divided and, nationally, weak. Most blacks support targeted vouchers for poor parents. Mr Draper wanted to introduce universal vouchers. The conservative Cato Institute prefers tax credits to vouchers. David Bositis, of the Joint Centre for Political and Economic Studies, points out that the two most important voting blocks in the population—white suburbanites and the elderly—are hostile to vouchers. That explains the movement’s ballot defeats last November in both California and Michigan, as well as George Bush’s current reluctance to push vouchers in education reform.

On the other hand, the centre of gravity of the voucher debate is plainly changing. An idea that was dreamt up by a white Republican, Milton Friedman, now depends on black support for its success. Where blacks embrace the idea, such as in Milwaukee and Cleveland, it prospers; where they withhold their support, as in Detroit, it fails; and in America’s vast white suburbs it is not even on the agenda.

This changing climate also applies to blacks and Democrats. The NAACP increasingly represent a reactionary and ageing fringe. (The average age of its leadership is far higher than that of organisations like the BAEO.) The Urban League, the other main black group, still hesitates to endorse vouchers officially. But its leaders are enthusiastic about things like charter schools, and some of its most prominent members, such as T. Willard Fair, are voucher evangelists.

But the biggest reason why the centre of gravity is shifting is simple: vouchers seem to work. A study by Paul Petersen, a Harvard professor, of black children who were selected by lottery to receive scholarships to private schools in three cities, Dayton, New York and Washington, found that they pulled ahead of their peers who remained in public schools. Meanwhile, they are not damaging public schools. In Florida, for instance, the threat that children would receive vouchers to attend private schools spurred the 76 worst-performing schools to make big academic strides. And, even if you get stuck in the many squabbles about such studies, there is the most powerful evidence of all: word of mouth. Blacks are telling each other that vouchers work.

It would be foolish to underestimate the power of the educational establishment: it seems capable of absorbing any criticism and neutralising any reforms. But supporters of vouchers have changed education in Milwaukee and Cleveland, and they are gaining support in other cities such as Philadelphia and Chicago. A national revolution is too much to hope for. But poor blacks may well revolutionise their educational opportunities city by city and state by state.

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The affair of that heart

Mar 8th 2001 | WASHINGTON, DC
From The Economist print edition

A FEW hours after Dick Cheney had *The Economist* round for coffee, he checked himself into hospital for a heart check-up. Lest this seem like journalistic boasting, there was no connection between these events: the vice-president seems perfectly capable of dealing with the press without breaking into a sweat. Would that the same were true of the administration itself.

AP

Prime minister

The White House called his cardiac catheterisation “a non-emergency precautionary procedure”. This is nonsense. Unplanned immediate invasive surgery is not done on a “non-emergency” basis. As the president-elect of the American College of Cardiology told *Salon,* an online magazine: “You do [the procedure] when you have information...that makes you think it might lead to a heart attack or an unstable angina which is a precursor to a heart attack.”

This does not mean Mr Cheney is so ill that he cannot carry out his duties: he resumed work after only two days’ rest. But it is the second time the White House has misled the public about his condition. After a minor heart attack in November (Mr Cheney’s fourth), the president said “the initial EKG showed he had no heart attack”—true, but a second EKG showed that he had.

Mr Cheney is the most powerful vice-president in history. He headed the White House group that settled spending disputes in negotiations for the budget; he heads the task-force to define a national energy policy; his role in security policy is at least the equal of the secretaries of state and defence. The White House should not be obfuscating about his medical condition.

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White-collar crime

Stealing people is wrong

Mar 8th 2001 | CHICAGO
From The Economist print edition

GEORGE HENDRICK, a stolid mid-west businessman, has a problem. His identity has been stolen. When collection agencies began calling him in January demanding payment for nearly $20,000 in purchases that he had never made, Mr Hendrick realised that some individual, still at large, had expropriated his name, his address and his Social Security number and then used them to go on a credit-fuelled spending spree.

Experts reckon that identity theft is one of the fastest-growing white-collar crimes in the United States. The number of consumer inquiries regarding identity theft to Trans Union Corporation, a credit bureau, grew from 35,000 in 1992 to 500,000 in 1997, at which point Trans Union stopped reporting its data publicly. The Privacy Rights Clearinghouse reckons that there are now roughly 750,000 cases of identity theft a year. John Ellingson, a privacy expert, says that the actual number of thefts may be higher, since many victims do not know how to report the crime—and others do not realise that it has happened.

Identity theft generally fits a pattern. The perpetrator steals the Social Security number of the victim and enough other supporting information to apply for credit cards, rent an apartment, open a mobile-phone account or take on some other financial obligation. The bills are diverted to a “new” address. Perpetrators may pay the accounts for some time, usually so that they can raise the credit limit and make a bigger killing later. When the perpetrator eventually defaults on these obligations—leaving bills that average $17,000, according to the Federal Trade Commission—the creditors come looking for the real George Hendricks of the world.

Consumers are protected by law from most fraudulent charges over $50. The real wreckage of identity theft lies elsewhere. Victims must first prove to sceptical creditors that the charges are fraudulent and then work tirelessly to clean up their credit record. A survey of victims conducted by the Privacy Rights Clearinghouse and the California Public Interest Research Group found that the average victim spent 175 hours over two years to regain financial health.

Some cases turn out even worse. If the perpetrator uses a stolen name and Social Security number to obtain a driver’s licence, then the victim may inherit legal problems as well. When Namia Allen, a law-school graduate, reported to her first day of work at the San Diego District Attorney’s office, she was handcuffed, arrested, jailed and strip-searched after a background check indicated that there was a warrant out for her arrest on drugs and weapons charges. In fact, a thief had broken into her car months earlier, stolen her vehicle registration and assumed her identity. Other people have been turned down repeatedly for jobs only to discover that they are listed in large databases as debtors or even arsonists.

Why is identity theft flourishing? Social Security numbers are now often the “unique identifier” required by the computer databases of employers, insurance companies, hospitals, universities, the army and banks. There they can be pilfered, either by a clever computer hacker, or, far more often, by a dishonest employee.

Meanwhile, credit-card companies are aggressively issuing unsolicited, pre-approved credit card applications. (Your correspondent’s dog was pre-approved for a platinum card when his name was used on the family subscription to the *New Yorker*.)

One scheme involves submitting a phoney change of address to the post office on behalf of a potential victim. The perpetrator then roots through the victim’s redirected mail, plucking out personal information and using it to fill out new credit-card applications that also come by mail. Meanwhile, the Internet provides ways of combining disparate pieces of information in devious ways. Something as innocent as a family genealogical tree can tip off a thief to a victim’s mother’s maiden name—a common way for credit-card firms to verify identity.

Most important, the risks of getting caught and prosecuted are relatively low. Congress passed a law in

1998 making identity theft a felony; most states have done the same. But prosecution is another matter. Credit-card companies seem loth to make much noise because they want to maintain public confidence. Prosecutors whinge that they do not have sufficient resources to prosecute violent criminals, let alone white-collar offenders who will rarely go to jail. Betsy Broder, assistant director of planning at the FTC, speculates that help will come only when businesses start marketing ways to stop identity theft.

One small comfort for Mr Hendrick is that he is in illustrious company. In December, Eldrick Woods (known better as Tiger) testified against a man who obtained a driver's licence and credit cards in his name and then went on a $17,000 shopping spree. Mr Woods pointed out that he would never have used his credit card to make a $100 down payment on a used Lexus since he is paid several hundred times that to endorse Buicks. The wretched Mr Hendrick, still trying to assert his innocence, does not have that sort of clout.

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Lexington

Managing the Big Apple

Mar 8th 2001
From The Economist print edition

DRESSED first as Marlon Brando in “The Godfather”, then as a surprisingly shapely-legged, stocking-clad Rockette, Rudy Giuliani stole the show at last weekend’s “Inner Circle” cabaret dinner. But the main talking point at the annual shindig was who would replace the term-limited mayor in November’s elections. The declared candidates have all been active in New York politics for years without ever setting the world on fire. Hacks parodied them at the Inner Circle in a spoof of “Fame”: “Some think we’re all the same. Lame. We’re going to run forever. Lame.” How much livelier the fight will be if two rather more exciting candidates throw their hats into the ring: Bill Clinton and Michael Bloomberg.

Of the former president, no more need be said at this juncture other than that the Big Apple is the only place on the planet outside Sodom and West Hollywood where his recent travails may actually increase the likelihood of him both running and winning. With his new base in Harlem, he will surely get the Democrat nomination if he wants it.

Mr Bloomberg, a colourful media tycoon, looks even more likely to win the Republican ticket. Late last year, just in time to be eligible for the Republican primary, he switched his party affiliation from the Democrats. He has been courting journalists and Republican insiders for months, and he has an increasingly impressive team of advisers. This week, Mr Bloomberg stepped down as chairman of his eponymous media company, saying with a use of caveats that suggest he is a natural politician, that although this did not mean he is running for mayor it is something he would have to do if he were.

New York is a naturally left-leaning city that has hitherto elected a Republican mayor only after several Democrat incumbents have taken it to the brink of disaster. Mr Giuliani won in 1993 at a time when crime was soaring alarmingly. Mr Bloomberg is probably the only potential Republican candidate who might buck this trend. His blue-collar roots, intelligence and ready wit will help. Other attributes that might go down badly in other cities—an obviously large ego and a divorce—might even endear him to New Yorkers. Mr Bloomberg’s private life has been more dignified than either Mr Clinton’s or Mr Giuliani’s. The *New York Post* even dubbed him the “anti-bimbo billionaire” for the 59-year-old’s extraordinary habit of dating women his own age.

But Mr Bloomberg’s greatest asset, by far, is that he is a successful businessman. That tag not only means he has the cash to get his message across; it is also shorthand for the message itself—bringing competent management into government. In this, he reflects a striking trend in American politics that has accelerated rapidly since 1992 when Ross Perot modestly tried to use his personal fortune to buy the presidency (on behalf of the American people, of course). Richard Riordan, a lawyer-turned-venture-capitalist, is just leaving a successful spell as mayor of Los Angeles. Maria Cantwell, of RealNetworks, a once-high-flying Internet firm, and Jon Corzine, former boss of Goldman Sachs, one of Wall Street’s top investment banks, each spent a large chunk of their personal fortunes last year in winning election to the Senate.

As for the Bush administration, it is positively overflowing with company bosses. The treasury secretary, Paul O’Neill, ran Alcoa, a large aluminium firm. Dick Cheney, though a veteran politician, was plucked from running Halliburton to seek the vice-presidency. Executives from General Dynamics, Northrop Grumman and Enron are being put in charge of, respectively, the navy, air force and army. Mr Bush, who once ran the business side of the Texas Rangers, seems to govern by Peter Drucker’s creed of management by objectives. And so far those goals have been fairly, well, corporate. His first two legislative coups have been restraining pesky occupational-safety laws and changing bankruptcy laws to help credit-card firms.

Managerialism may go down well with New York's voters. Mr Bloomberg's rivals talk of preserving Rudy's legacy, but they are all less business-friendly than the mayor. Mr Bloomberg's people stress that the Big Apple's future depends on it remaining a magnet for business. That in turn depends on it remaining safe from crime (Mr Giuliani's forte), as well as improving schools and lowering taxes (not his forte).

The authoritarian skills that allow American bosses to thrive do not always transfer easily to the democratic goldfish bowl that is government. Mr Perot always looked as if he was about to sack anyone who voted against him. At the Treasury, Mr O'Neill has discovered that the sort of "no-bull" speaking your mind that works wonders in the boardroom can cause no end of trouble in the political arena. But, when it comes to style, Mr Bloomberg would have the advantage of following Mr Giuliani: it is hard to imagine how any successor could be less tactful or more authoritarian.

More worrying are the conflicts of interest that can arise when businessmen enter government. This week, Mr O'Neill revealed that he intended to retain ownership of Alcoa share options worth an estimated $100m (in contrast to Mr Cheney, who disposed of his Halliburton options). The treasury secretary has promised to recuse himself from decisions affecting Alcoa—a ridiculous idea, since taken literally, this would mean everything from corporate taxation to exchange-rate policy. Mr Bloomberg has said he would not sell his media company if he became mayor. But he has already talked of returning tax breaks worth $14.4m that the company received last year as an incentive to stay in the city.

The other source of unease would be Mr Bloomberg's use of his own money to fight for office. Alone among possible candidates, he is unlikely to participate in the city's voluntary campaign-finance system, which he has called "an incumbent-protection programme". But, unlike Mr Corzine, he has at least promised to publish his tax returns. It would be ironic—and, on reflection, extremely unlikely—if the shopping and financial capital of the world were to balk at a rich businessman buying an election. Or as Mr Bloomberg has so artfully put it, "What's a billionaire got to do with it? I mean, would you rather elect a poor person who did not succeed? Look, I'm a great American dream."

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Latino heroes

John Wayne, in Spanish

Mar 8th 2001 | RESERVE, NEW MEXICO
From The Economist print edition

NEW MEXICO, the home of Pat Garrett and Billy the Kid, has always had a soft spot for desperadoes. Its most recent would-be hero, arrested last month after a sharp gun battle, is “Handsome” Shane Chubbuck, a poetry-loving bank robber who left female cashiers applauding his kindly promise that the money he had just stolen would go to help Zapatist rebels in Mexico. Now an attempt is being made to revive the memory of a gunslinger who genuinely deserves a raising of the hat. The people of Reserve, a town in Catron County, out in the west of the state, want the state legislature to put up $100,000 for a memorial to Elfego Baca.

In October 1884 a gang of 80 Texan cowboys arrived in Reserve and started to spread terror among the local Mexicans. Women were lassooed and taken off to be molested. The local law-enforcers just got drunk. When the story reached Socorro, another predominantly Latino town 130 miles away, Baca, a 19-year-old shop assistant, set out to put things right.

His first act was to arrest one of the raiding cowboys. The other cowboys tried to free him, and one of them was killed. After a night of violence, Baca brought the arrested man before a judge, but an angry mob chased him to a *jacal,* a flimsy building made of wooden posts, mud and straw. There began a classic gun-fight, lasting more than 30 hours, in which some 4,000 shots were fired. The cowboys tried to burn him out, but Baca eventually emerged unscathed, to the delight of the assembled crowd, and duly passed into local folklore.

Unlike Billy the Kid, Baca was soon highly respectable. Acquitted of the murder of two of the cowboys, he turned to politics. Elected sheriff of Socorro, he proved his marksmanship by shooting the heads off 20 chickens, and sent a letter to all the outlaws in his neighbourhood, calling on them to give up, or face his “lethal displeasure”. Later he became mayor and ran for governor. His reputation for being unkillable was enhanced when he survived being run over by a fire engine and stabbed with an ice pick. He was 80 when he died, in 1945. He then almost vanished from history; the closest Hollywood got to remembering him was a children’s feature from Disney in 1958.

To be sure, there was always another point of view. Descendants of the cowboys he beat have disputed Baca’s account of the fight in Reserve. He was also once indicted by a federal jury on conspiracy charges relating to a jailbreak (his alibi held). But Baca seems as worthy of respectful attention as Billy the Kid, for whom some local politicians are currently demanding a pardon. He seems almost the ideal Mexican-American hero. Even Cesar Chavez, the famed Californian farm workers’ leader, never held off 80 gunslingers single-handed.

The idea of a memorial comes from Henry Martinez, the owner of Reserve’s only petrol station. Mr Martinez has good cause. His great-grandfather, Epitacio Martinez, was used for target practice by the Texan gang before Baca arrived. But he is also hoping to attract tourists to Catron County.

Much of the county lies inside the Apache and Gila National Forests, an area of ancient, spectacularly wooded mountains. But its median household income, $22,661 in 1997, is only 61% of the national average. It gained brief notoriety in 1994 by passing a resolution requiring every household to own a gun (it was never enforced). It has recently been arguing with the federal government over the latter’s reintroduction of wolves into the area. An investigation is under way into a wolf found slain in nearby Apache Creek. Maybe another Elfego is needed, riding to the rescue.

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Wind power

Maybe this time

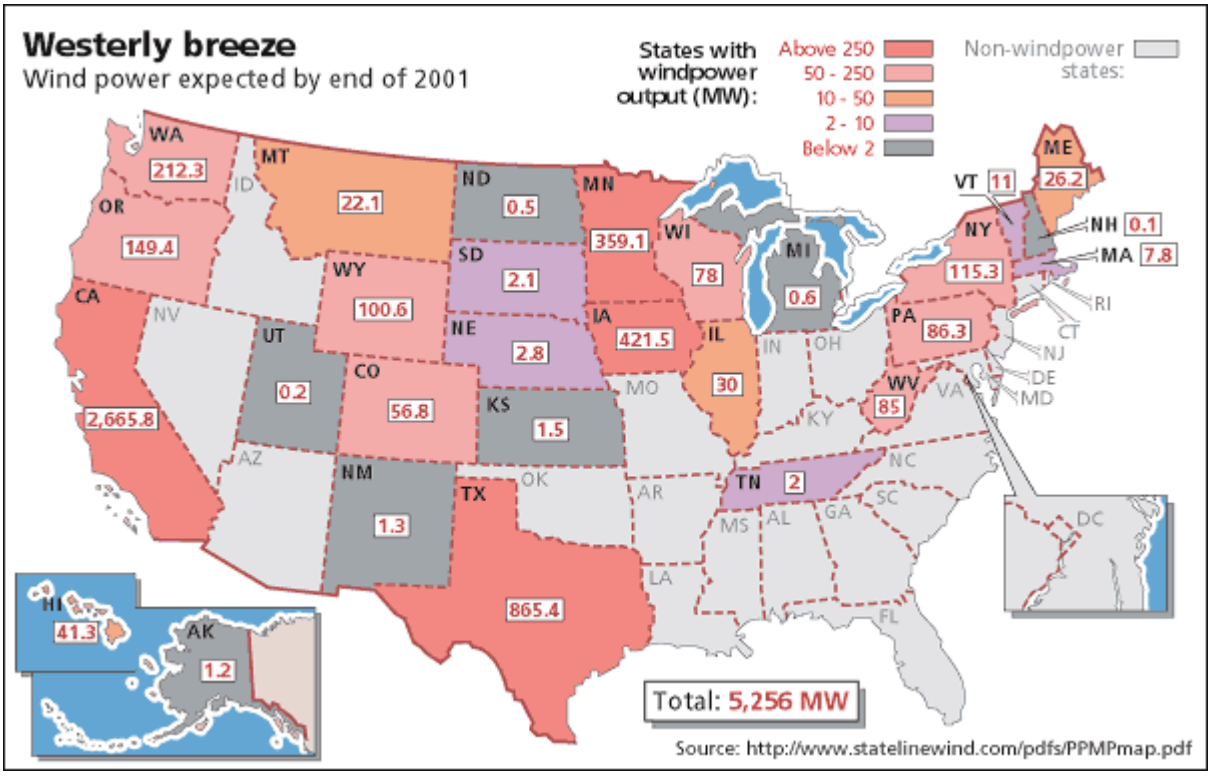
Mar 8th 2001 | SEATTLE
From The Economist print edition

WIND power has long been the Next Big Thing in energy. In the 1980s, tax credits for wind-turbine construction led to the building of thousands of turbines, mainly in California, but to little extra real power. Another tax credit—this time for actually producing electricity, not just making a noise about it—came in 1992. But this too led nowhere much, because of the ever-rising efficiency of fossil-fuel generation and the unexpectedly low prices of those fuels. Wind power still looked uneconomic.

Gantenbein

The answer, my friend...

But now a happy (for the wind industry) confluence of California's energy woes, soaring natural-gas prices and better wind-power technology may at last make the gift from the skies worth grasping. Already, this looks likely to be the best year in the American wind-energy business's history.



The giant Bonneville Power Administration—which operates a series of massive hydroelectric dams in the Pacific north-west—said in January that it would buy up to 1,000 megawatts of wind energy by 2003. This by itself represents nearly half the current wind-generating capacity in the United States. A little earlier, FPL Energy announced plans to build the largest "wind farm" in the world on a gusty plateau straddling the border between Oregon and Washington states. Its 470 turbines will produce enough power for 70,000 homes. Enron, an energy company, recently erected 200 turbines in California and West Texas, and another 500 in Minnesota and Iowa.

The energy crisis of the past few months, in short, has made Americans look at wind with a new interest—and this time the interest may be justified. Thanks to dramatic advances in wind-turbine technology, the costs of setting up and operating wind generators now approach those of gas turbines, even without subsidies.

These generators are less and less expensive to erect. A big 1.65MW turbine costs about $1.3m, roughly 20 times that of its 1980s predecessor. But the new machine puts out 120 times as much energy. And wind farms are relatively quick to build. In Oregon, FPL Energy has not even broken ground on the project, but expects to have it running by the end of the year. Gas-fired plants, on the other hand, may take five years to build. And dams? Forget it. Wind-turbine reliability, long a bugbear as frail units flew apart in heavy gusts, is also improved: they should work now close to 98% of the time.

The new turbines also answer some of the environmentalists' criticisms. The old, small turbines were a noisy eyesore because so many of them were needed. They also killed a lot of birds. Today's bigger turbines are taller, with blades that spin more slowly, so that birds can more easily see the blades and avoid them, says Chuck McGowin, of the Electric Power Research Institute in Palo Alto, California. And, with fewer turbines needed to produce the same amount of power, they can be spread more widely, making them easier on the eye.

Still, wind machines will not solve America's energy problem. California, for instance, has more than 7,000 wind turbines (admittedly most of them the little, old ones), yet they produce only about 1.5% of the electricity the state needs. Even with new turbines going up fast, by the end of 2001 America's total wind-generating capacity will be only about 5,250MW. The Bonneville hydroelectric dam on the Columbia River, near the site of the Oregon windmills, produces a fifth of that all by itself. The United States is far behind countries such as Denmark and Germany, which generate four times as much wind power.

The problem is that the wind blows when it blows; it can't be dammed like water, or stuck in a tank like natural gas. And, notes Mr McGowin, in many places it tends to blow when demand is low, such as in the middle of the day, and dies down in the evening, when Americans watch television (400 kilowatt hours per year) and run dishwashers (1,570). It is technically possible to store wind energy. In California, one facility uses wind-generated electricity to pump water uphill during times of slack demand; the water is then released at peak hours, to drive turbines and create electricity. But it is a costly and complex process. And wind turbines still look big and ugly.

Even so, compare wind with other sources of energy—oil, with its risk of spills; coal, which is dirty; dams, which kill fish; or natural gas, with its volatile costs—and the idea that it is a gift from the skies no longer looks so silly.

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Trouble in McArkansas

Mar 8th 2001 | LITTLE ROCK
From The Economist print edition

ALL through the pages of Scottish lore, clans have quarrelled over cheating wives, stolen livestock and who could hold the place of honour in battle. In Arkansas, they are fighting over something even more important: their tartans.

The *casus belli* was a law to create a state tartan, honouring Arkansans who possess Scottish ancestry. The bill was introduced by a well-connected Republican laird, Jeremy Hutchinson (son of Tim, a United States senator, and nephew of Asa, a powerful congressman). Georgia, Maine, New Hampshire and Connecticut have their own tartans. And April 6th is National Tartan Day, marking the fact that more than half the signers of the Declaration of Independence were Scots.

Mr Hutchinson introduced his bill, on behalf of a couple named Brandon, amid much Celtic fanfare. He passed out plaid buttons, as a Scot in a kilt roamed the state capitol. During a session in which legislators are dealing with hate crimes, abortion and gun control, this bill seemed bound to pass: “cute”, as Mr Hutchinson described it.

Mr Hutchinson chose a tartan, the Natural State plaid, that includes most of the magic of the Natural State, as Arkansas likes to be known: green, for the wilderness of Arkansas; red for the state’s original settlers; stripes of white for diamonds (Arkansas has the only diamond mine in North America); and stripes of black for oil. (Those still feeling delicate about a certain Arkansan presidency could construe the magic colours differently: green for dollars, red for faces, white for water, and black for the source of Marc Rich’s wealth.)

Unfortunately, this colouring enraged the members of Scotia, a group of Celtic Arkansans who organise a Scottish festival. They had originally worked with the Brandons on a similar tartan, designed by a young weaver, Jason Nickerson. Protesting on their behalf, Roger Smith, a Republican legislator, introduced his own law to create an “official state Scottish tartan”, called the Arkansas Traveller, designed by Mr Nickerson.

The Brandons, who claim that the Arkansas Traveller is unweavable, met Scotia in an attempt to create one state tartan. The talks, which Mr Hutchinson says were as heated as Middle East peace negotiations, broke down. Messrs Hutchinson and Smith then agreed to combine their laws into one bill, creating two state tartans. But this week, the Senate rejected the bill: only five of its 35 members supported it. Now both Mr Hutchinson and Mr Smith are reintroducing separate bills—and the two halves of Celtic Arkansas are as close as the Macdonalds and the Campbells after the Glencoe massacre.

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George Bush's tax cut

There is no alternative

Mar 8th 2001 | WASHINGTON, DC
From The Economist print edition

AP

Full speed ahead

WELL, that didn't take long. "There is no bipartisanship on this issue [taxes]", says David Bonior, the Democratic whip in the House of Representatives. Just two days after the president had presented the outline of his budget to Congress, complete with the refrain "let us agree to bridge old divides", the bit of the legislature responsible for starting the budget process, the House Ways and Means committee, rammed the centrepiece of it—ten years of income tax cuts—through the initial committee stage with unusual haste and no Democratic votes.

It is not clear whether the administration planned this or merely acquiesced in the decision of Republican legislators. But either way, Democrats are livid. As *The Economist* went to press, George Bush's tax cut was proceeding to the full House for debate. It seemed unlikely that more than a handful of Democrats would vote for it. Just to annoy them further, House Republicans were not allowing the Democrats to put their alternative tax plan up for discussion.

On the face of it, such tactics seem reckless. Tax cuts cannot be railroaded into law on the basis of the (slender) Republican majority in the House of Representatives alone. The Senate must have its say. And even though President Bush can get a budget through the Senate with the 51 votes his party now has (budget debates are protected from the usual Senate rules that require 60 votes to do anything), he still has to get the tax-cut bill passed by a committee where there are equal numbers of Democrats. So, says Senator John Breaux, a Democratic member of the committee, "people who want to get something done are going to have to negotiate."

Moreover, the damn-the-torpedoes approach has helped rally Democrats against tax cuts. Before the debate, they were in a funk, unable to decide whether to attack the plan as too big, too unfair, or too risky. Now, they seem to be settling on the last notion, arguing for a "trigger mechanism" that would make tax cuts and spending rises dependent on progress in paying down debt. Five Senate Republicans also favour this idea.

So why is Mr Bush pushing ahead so fast? A small part of the answer may be, to put it bluntly, he wants to get tax cuts passed before illness or death changes the balance of the Senate. But there is a more substantial reason. Voters say they want bipartisan co-operation not for its own sake, but in order to get things done.

Mr Bush seems to be calculating both that he can get most of the tax cuts through Congress on Republican votes alone, and that victory on that score will count for more than any bipartisan niceties. After all, Mr Bush's first budget will define his presidency just as that of 1981 defined Ronald Reagan's and the deficit-reduction bill of 1993 defined the successful bit of Bill Clinton's. And if his tactics push Democrats into declaring war on tax cuts, then so much the better.

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Can Lopez Murphy save Argentina?

Mar 8th 2001 | BUENOS AIRES
From The Economist print edition

Growth must go faster if investors, and the IMF, are to feel happy

Get article background

AP

ONCE again, Argentina's Alliance government has been overtaken by events. Faced with faltering economic growth, soaring country risk (the interest premium Argentina pays for its debt) and evaporating support, Jose Luis Machinea surprised President Fernando de la Rua by resigning as economy minister on March 2nd. The Argentine stockmarket rejoiced, surging by 2%. It went up another 8% after the weekend, when Mr de la Rua named Ricardo Lopez Murphy to succeed him.

Investors, who never quite trusted Mr Machinea, positively like Mr Lopez Murphy. He is a conservative, a pillar of economic orthodoxy and, to reinforce his neo-liberal credentials, has a master's degree from the University of Chicago. His appointment has calmed their nerves. But Argentina is not out of the woods yet and, as if admitting this, share prices dropped by 2% on March 6th.

In its attempts to break out of a recession that has lasted for 33 months, Mr de la Rua's government has tried many a miracle cure before this one. First there were tax increases. They did not work. Then there was a huge bundle of public-spending cuts, worth over $900m, in May. No joy. In December, as rumours mounted that Argentina would default on its debt, Mr Machinea was obliged to negotiate a $39.7 billion credit line with the IMF. Making a virtue out of necessity, the government launched a media campaign to assure the public that its measures made Argentina a risk-free proposition and that growth was guaranteed.

Barely two months later, with no noticeable upturn in demand, it is clear that the medicine has again failed. Continued stagnation has hit tax revenues. They were flat in January, while spending was unexpectedly high; the result was a fiscal deficit in January of $940m. This means that Argentina will exceed the spending limits it agreed to with the IMF by around $300m in the first quarter, according to Fundacion Capital, an economic think-tank.

Mr Lopez Murphy has praised his predecessor, and will preserve many of his policies. But whereas Mr Machinea never quite seemed to believe in what he was doing, Mr Lopez Murphy has one absolutely clear principle: fiscal prudence.

This sounds encouraging, but there is one large problem. Mr Lopez Murphy fails to inspire either the less conservative wing of his party, the Radical Civic Union, or Frepaso, the leftist junior member of Mr de la Rua's Alliance coalition. Tellingly, the leaders of both parties snubbed him by failing to show up at his inauguration. Moreover, although the cabinet resigned after Mr Lopez Murphy had requested it to allow ministerial changes, the ministers all promptly returned to their posts.

This lack of support will make a great difference to what Mr Lopez Murphy can do. His first priority must clearly be to get the budget deficit under control. This means, first, spending cuts. But clamping down on Argentina's pork-barrel tendencies, as well as curbing spending in the provinces, will be a tall order, especially with congressional elections coming up in October. The opposition Peronists, who control the biggest provinces and currently have a majority in Congress, have said they will oppose most cuts in

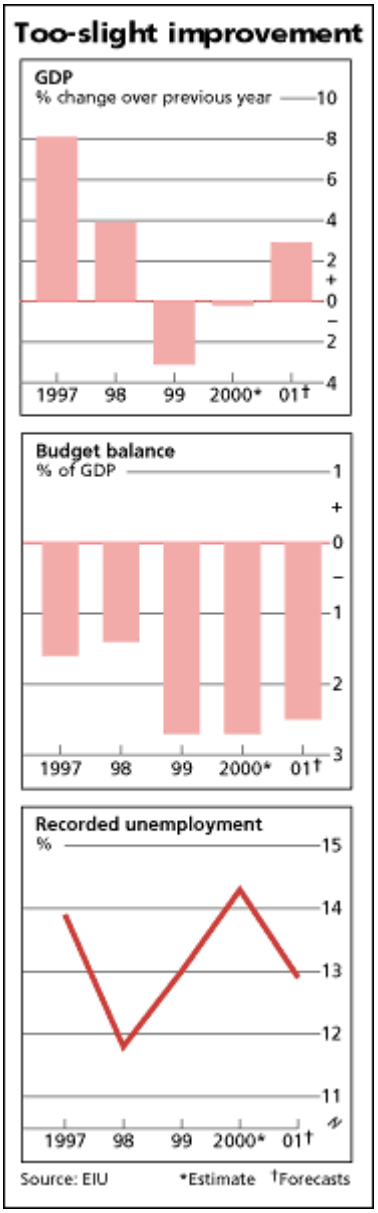
spending.

Despite Mr Lopez Murphy's pleas for support, he also faces opposition from his own side. Rank-and-file Frepaso members, in particular, will be unhappy at this latest turn to the right by the government, although Mr de la Rua will attempt to co-opt its leaders with the offer of more posts in his administration. Skilled political deal-making (as well as efforts to persuade the Peronists of how deeply Argentina is in trouble) will be the key to driving through fiscal reforms; for although Mr de la Rua and Mr Lopez Murphy can do a certain amount by decree, even decrees can be overturned.

Nevertheless, the president clearly feels that the left, having helped him to power, is now a hindrance. He has already put out feelers to Domingo Cavallo, a political independent, who may be appointed governor of the Central Bank. Mr Cavallo enjoys prestige as the author of the convertibility system that pegged the Argentine peso to the dollar under the previous government. He also brings with him his own political party, Action for the Republic, which has about 10% of the deputies in Congress.

Yet Mr Cavallo has his downside. He is heartily loathed by many members of the Alliance, and he also gets on none too well with Mr Lopez Murphy. (For example, Mr Cavallo, less rigorously orthodox in his thinking, would like some growth-spurring measures that the economy minister does not want at all.) Foreign investors may regard these two as a dream-team on paper, but their closest point of agreement is that both would like to be president. That does not make for civil dealing.

In the end, much will depend on Mr de la Rua's leadership. The charge of vacillation that has been levelled at Mr Machinea has been levelled just as often at the administration as a whole. The president's new choice of economy minister has again bought him breathing-space. But, sooner or later, he will have to show that he is in command of the country, not just cabinet appointments.



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Brazil

Fiscal prudence goes local

Mar 8th 2001 | CAMPO GRANDE
From The Economist print edition

Governors and mayors across Brazil are making unprecedented efforts to balance their books. There's a big mess to clear up

CAMPO GRANDE, the capital of the state of Mato Grosso do Sul, is usually a tranquil place. The state's business is mostly farming, cattle and soyabeans, on flat bushland; city life, as offered by Campo Grande, is clean and rather dull. In recent weeks, however, the state government's offices have had a spate of bomb threats. All were hoaxes, but they seemed intended to tell the governor, Jose Orcirio dos Santos of the left-wing Workers' Party (PT), that he had infuriated some people with his programme to cut spending and reform the state's finances.

Mr Santos—much better known as "Zeca of the PT"—became governor early in 1999 and, at first, behaved as you might expect of a former trade unionist whose party is the main opposition to Brazil's government and its "fiscal adjustment" programme. He promised to "govern for the workers" and gave big pay rises to teachers, health workers and police, taking the state's already precarious finances closer to the brink.

Then, suddenly, he did an about-face, launching a programme to reduce spending while boosting tax collection. The number of political appointees in the state government has been cut in half, to 1,600, and thousands of permanent staff are being offered voluntary retirement. Loss-making state firms have been shut. Tax-dodgers are being pursued more assiduously, over-generous tax breaks to the state's big meat-processing industry are being scaled back, state workers' pension contributions are being raised. As a result, the state's finances have swung from a primary deficit (ie, a deficit even before paying debt interest) to a primary surplus.

Mr Santos—an emphatic man who shouts rather than talks, stabbing his finger, as though he is still addressing one of his union rallies—claims, improbably, that he has always believed in sound finances. But what seems to have forced his conversion is Brazil's new fiscal-responsibility law, which came into force last May. This bans the federal government from bailing out debt-ridden states and cities, as it has done repeatedly in the past; it limits federal, state and municipal borrowing and payroll costs; and it bans politicians from leaving their successors a stack of unpaid bills. Offenders may be banned from office or even jailed.

The governor's example is now being followed by the mayors of the state's 77 municipalities, says Adilson Trindade, political editor of the local *Correio do Estado.* They are scrambling to comply with the new law, cutting their own and councillors' salaries, exorcising "ghost" workers from the payroll and starting to charge local taxes, instead of simply borrowing or living off transfers from the federal and state governments.

The good behaviour seems to be catching. Since early 1999, when Congress started debating the fiscal-responsibility law, the states have gone from a primary deficit to a primary surplus; and the municipalities have stayed in primary surplus (see chart) even in the approach to last October's local elections, traditionally a time of wild overspending. Raul Velloso, who follows matters of public finance, says most of the improvement has been the result of more efficient tax collection and the higher tax revenues that come with economic growth, as much as of governors' and mayors' efforts to raise taxes. That said, in the past such extra revenue would have been frittered away on grand public monuments and jobs for the boys, not used to stabilise local finances.

Still, such efforts can only be a start, not least because of the burden of debt left behind by previous governors and mayors. In Mato Grosso do Sul, the obsession of Mr Santos's predecessors with grandiose public works (including a $250m, or 500m *reais*, Palace of Culture with huge expanses of polished granite flooring) have left the state with debts of 4 billion *reais*, mostly with the

federal government. The repayments it makes under a deal with the national treasury are insufficient to cover the interest on the debt, so the lump sum owing continues to rise. Furthermore, the state has another 4 billion *reais* of unfunded pension liabilities. Mr Santos has started a pension fund, endowing it by selling a few state companies, but it remains far short of what is needed.

The main danger, says Mr Velloso, is that one of the biggest states or cities may get into such a mess that Congress comes under irresistible pressure to rewrite the fiscal-responsibility law. Fortunately, the finances of Sao Paulo state, by far the largest, were stabilised under the six-year governorship of Mario Covas, who died this week. The wobbliest candidates are the states of Rio Grande do Sul and Minas Gerais and the city of Sao Paulo, all governed by left-wing opponents of Brazil's president, Fernando Henrique Cardoso. The governor of Minas Gerais, ex-President Itamar Franco, triggered Brazil's 1999 devaluation by threatening to default on his foreign debt; but after having his federal grants stopped by Mr Cardoso he relented, and has since been paying his bills. Sao Paulo's new mayor, Marta Suplicy, whose incompetent predecessors left 18 billion *reais* of debts, has so far seemed determined to bring the city's finances under control, conscious that her progress will affect her hopes of running for president in 2006.

Mr Santos insists that Brazil's recent conversion to fiscal rectitude is permanent. "The era of the big-spending state is over," he says. That really depends on the politicians Brazilians choose to lead them in future. A promising sign, says Mr Trindade, is that in Mato Grosso do Sul, as elsewhere, last October's municipal elections seemed to continue a trend in which voters have rewarded competent mayors and rejected populists. The governor will run again next year and, so far at least, no rival has come forward offering a return to the free-spending past.

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Quebec

Over to Landry

Mar 8th 2001 | QUEBEC CITY
From The Economist print edition

CAN Bernard Landry take Quebec any closer to statehood? As the province's new premier was sworn in on March 8th, many hoped so. But the road ahead is hard.

Lucien Bouchard, Mr Landry's predecessor, resigned suddenly in January, despairing of the task. Mr Bouchard was a dynamic and magnetic leader, but his secessionist ardour was frequently in question; he had, after all, been a federal cabinet minister and an ambassador for Canada. The naturally quarrelsome Parti Québécois (PQ) bickered so much over the question of his zeal that it eventually drove him out.

Mr Landry, who was formerly Quebec's finance minister (and who managed to balance the budget, though not without some creative accounting), is on the dull side. But his credentials in the independence movement are unequalled. Not only has he served as a loyal lieutenant to all four previous PQ premiers, including Mr Bouchard, but he has been an *indépendentiste* for 40 years—well before the term was even thought of.

The PQ government in Quebec is midway through its second mandate. The party has already held, and lost, one referendum on secession, in 1980. Support for separatism then fell away, until in 1984 the party shelved the idea. It almost fell apart as a result. Under Mr Landry, history will not be repeated.

To prove it, he has been positively rude towards the rest of Canada in recent weeks. As finance minister, just after he had said he would seek the premier's job, he refused an $18m federal grant for a zoo because, as a condition, he had to fly the Maple Leaf flag over it. "Quebec has no intention of whoring for bits of red rag," he remarked. Later, when it was announced that the province would receive an extra $1.5 billion under the programme that redistributes wealth from richer to poorer provinces, Mr Landry said Quebec was humiliated to be considered a have-not. This prompted Ralph Klein, Alberta's premier, to call Mr Landry a greater threat to national unity than Mr Bouchard ever was. "Damn right," Mr Landry replied.

Yet while Mr Landry fires away with both barrels, support for secession in Quebece refuses to budge from around 40%. And it seems to be the last thing most people want to hear about. In the past, Mr Landry has hurt himself by ignoring popular sentiment. As Robert Bourassa, a former premier of Quebec, is reported to have said of him: "Always brilliant. Sometimes intelligent."

Some of Mr Bouchard's troubles with the PQ stemmed from his refusal to call another referendum after the pro-secession forces came within a percentage point of winning in 1995. Mr Landry, with his unquestioned dedication to the cause, will probably be forgiven if he does not hold one. Opinion polls suggest that only 10% of Quebeckers want a quick referendum, and 49% never want one again. He himself has said he would rather lay the ground first, doing all he can to establish that, as he puts it, "historically, mentally, factually, Quebec is a nation."

His best chance to make his case, he had been hoping, would come in April, when he plays host to the Summit of the Americas in Quebec city. But Canada's prime minister, Jean Chrétien, has announced that Mr Landry's appearances there will be restricted, mostly to meeting people at the airport; that if he wants to speak to other leaders, he will have to submit a request to the federal government; and that he will certainly not be allowed to make a speech. Mr Landry is unlikely to take all that lying down.

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A change of tiempo in Mexico

Mar 8th 2001 | MEXICO CITY
From The Economist print edition

TIME has never been a precise concept in Mexico. To be punctual for an appointment is rare, and to be at a party at the stated hour is considered almost bad manners. Now a surreal row over daylight saving time is threatening to shatter this already fragile notion of time into several different, and competing, pieces.

In 1996, Mexico began moving its clocks forward an hour in the spring and back in the autumn. This brought the country into line with its new free-trade partners, the United States and Canada, as well as saving a purported $600m-worth of energy a year. But every spring has brought complaints that daylight saving forces people to get up in darkness, at least at the beginning and end of the periods. Vicente Fox, who became president last December, therefore announced that summer time would start a month later and finish a month earlier.

The states along the northern border then started to worry about the effects on trade with their United States neighbours. So the president said they could stick to a seven-month summer, starting in April, while the rest of the country would wait until May.

Meanwhile, Andres Manuel Lopez Obrador, the left-wing mayor of the Federal District (DF), the core of Mexico city, was not happy. He came to power in December promising to review (ie, abolish) daylight saving time, which he sees as an imposition by the forces of foreign capital. DF residents were invited to call in for a telephone poll, which predictably found that most people were against changing the clocks. And so Mr Lopez, arguing that Congress alone should be the arbiter of time, asked the Supreme Court to overturn Mr Fox's ruling and decreed that the DF would have no summer time at all.

The uproar was immediate. Since less than half of Mexico city's residents live within the limits of the DF, millions would have to change their watches every time they commuted to and from work. The education minister, Reyes Tamez, stood up for the president, insisting that no matter what time Mr Lopez said it was, schools would run to the same time inside the DF as outside it. In response to protests from business, though, Mr Lopez relented a little. He offered to apply daylight saving time in the stock-exchange building, so that it could keep in step with New York.

The Supreme Court has promised to rule before the days get too long. Some think, however, that Mr Lopez is interested only in publicity, his eyes already on the presidential election in 2006. If so, he has made a bad start.

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China's confident bow

Mar 8th 2001 | BEIJING
From The Economist print edition

With big new spending increases, especially for defence, and stern warnings about Taiwan, China is looking bolder

Get article background

AP

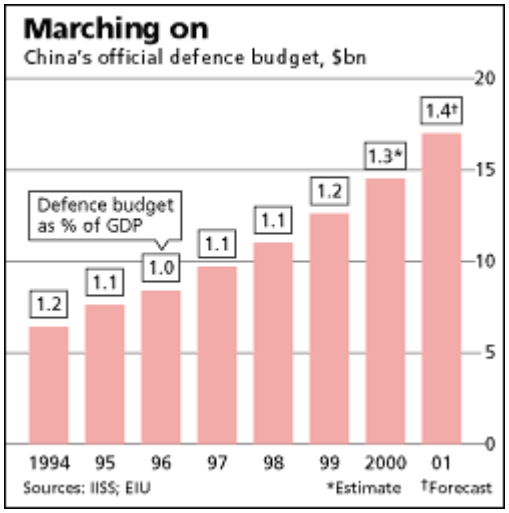
REGULAR as the spring, China's National People's Congress (NPC) opened this week in the cavernous Great Hall of the People with all the pomp that makes it one of the last great set-pieces of absolutist political theatre. Though the 2,978-strong NPC, nominally China's highest body, is a rubber stamp for decisions already made by China's real rulers in the Politburo, it is still the place where policy is revealed, views exchanged and big announcements made.

This year's NPC did not disappoint. Starting the two-week session, Zhu Rongji, China's prime minister, outlined goals for reforming the national economy and supposedly doubling its size to $2 trillion by 2010. The Falun Gong spiritual movement was castigated at the highest level, revealing just how spooked the Communists are by a group that claims more members than they do. Xiang Huaicheng, the finance minister, revealed a new 2001 budget that will rely on deficit financing to allow hefty spending increases on agriculture and education, and a 17.7 % rise in military expenditure. And Tang Jiaxuan, the foreign minister, took the opportunity to warn America of "serious dangers" if it proceeds with the sale of advanced weapons to Taiwan.

Denying that China's "normal" increase in defence spending has anything to do with Taiwan, Mr Tang nevertheless made clear that tensions with the offshore island pose a grave threat to relations with America. Of prime concern is the Bush administration's decision, due in April, on the sale of Aegis battle-management systems and upgraded Patriot anti-missile systems to Taiwan. America, Mr Tang said, "should rein in its wild horse right at the edge of the precipice". China's vice-premier and former foreign minister, Qian Qichen, goes to Washington on March 18th to deliver the same message directly to President George Bush.

China's defence spending has been rising steadily since the Gulf war ten years ago first revealed to its military planners just how far they had fallen behind. But coming as it does in the midst of a long stretch of negative or near-zero inflation in China, this year's rise to $17.2 billion is, in real terms, by far the largest. The adjustment, Mr Xiang explained, is partly meant to counter "drastic changes" in the international military situation—presumably a reference to NATO's successful use of air power in 1999 against the Yugoslav army in Kosovo, and America's plans for missile defences.

It is widely reckoned that China, like many countries, reveals only a portion of its military spending in its published budgets and that actual spending is between three and five times higher than it says. But China can probably be believed when it says much of the new spending will go on pay rises for its soldiers. Placating the army makes good political sense. In the past two years, it has been forced by reformers out of some (but not quite all) of the lucrative businesses, from swish hotels to telecoms, it used to be involved in. Despite the unity that China's leaders strive to project, they are in fact manoeuvring ahead of next year's shuffle, when the president and Communist Party chief, Jiang Zemin, is due to step aside, along with most of the Politburo's powerful Standing Committee. Given the rocky path these things often take in China, a few billion dollars spent keeping the army chiefs on side is a sound investment.



Transition politics also explain the rather tentative domestic initiatives put forth this year at the NPC. Mr Zhu gave a warning that China faces “many arduous tasks”, among them the reduction of the government’s role in the national economy, and preparations for entering the World Trade Organisation. At times he flirted with the bold, announcing, for example, that the state must retain control of “strategic” enterprises, “but not necessarily in others”. This will be taken by many as approval for a new wave of mergers, privatisations and listings.

But he also hedged, introducing the tenth five-year plan by saying, in effect, that it would involve less planning. “It contains fewer specific targets and sets more tentative ones adjustable to structural changes,” declared Mr Zhu. One target he did set was for economic growth of about 7% in each of the next five years, less than the average growth of 8.3% over the past five years, but ambitious nevertheless. To help achieve it, China would continue its heavy infrastructure spending, starting with an extra $18 billion in bond issues this year.

Mr Zhu also reported on progress toward the targets he set upon becoming prime minister three years ago. The goal of turning round the huge loss-making state sector had, he said, been “basically attained”, with profits of state-owned industrial enterprises coming in last year at about $29 billion, 190% higher than in 1997. Much of that increase, however, was from state-owned oil firms in the form of higher oil prices, rather than from any broad rise in overall industrial efficiency. Worse still, state auditors have found that two-thirds of the state-run firms they checked last year had padded their books with billions of dollars of fake profits. There is plenty for Mr Zhu still to do.

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South Korea and America

Lots to talk about

Mar 8th 2001 | SEOUL
From The Economist print edition

Dealing with North Korea can try the patience of even the best of friends

WHEN South Korea's president, Kim Dae Jung, met his American counterpart on March 7th in Washington, the warmth was genuine. George Bush wants to burnish ties with America's allies; South Korea, home to 37,000 American troops and at the heart of the diplomacy with still prickly North Korea, is a close ally. Mr Kim, for his part, had wanted Mr Bush's blessing for his "sunshine" diplomacy towards North Korea, which has offered the regime there all manner of economic inducements to warm relations. Despite the goodwill, that was not quite how it turned out. Indeed, the two men are in danger of getting at cross-purposes.

Mr Bush shares none of Mr Kim's enthusiasm for rapid re-engagement with North Korea, and told him so in their "frank and candid" chat. He is also wary of South Korea's plans to sign a largely symbolic, but possibly distracting "peace declaration" with North Korea. For Mr Bush, the threat from North Korea's proliferation of missiles and other weapons is the chief issue.

Furthermore, during a recent visit by Vladimir Putin to South Korea, Mr Kim had appeared to endorse the Russian president's voluble opposition to America's plans for anti-missile defences. A clumsy attempt to placate Russia, and China, in the hope that they will press North Korea to improve inter-Korean ties more quickly? Or simply a gaffe by South Korea, which cares less than America does about the North's production and sale of longer-range rockets (one of the reasons America gives for wanting defences), since the more immediate danger to the South comes from the much-shorter-range artillery pieces dug into the hills across the border? Mr Kim back-tracked, but it took a little of the shine off his Washington visit.

The threat of serious disagreement looms. Like some of Mr Kim's critics at home, Mr Bush would like him to press for more "reciprocity" in his dealings with North Korea. So far, since a North-South Korean summit last June, and in return for continuing handouts and the promise of big loans and investments to come, North Korea has allowed people from just 300 divided families to meet, agreed to open up a cross-border freight rail link (no subversive passengers, please), and repeatedly put off a return visit to Seoul by its leader, Kim Jong Il.

The Bush team want to break the habit the Clinton administration had got into of responding each time to North Korea's pressure and threats with more bribes in the form of aid or diplomatic attention. They therefore responded dismissively last month when an impatient North Korea threatened to resume the missile-testing and plutonium-making that have periodically plunged the peninsula into crisis.

Any checks?

The southern Mr Kim did win assurances this week that America had no intention of abandoning efforts to engage North Korea in more constructive pursuits than its past nuclear and missile efforts. Mr Bush's secretary of state, Colin Powell, went so far as to say he saw "promising elements" in a deal, now under review, that had been partially negotiated by the Clinton administration to end North Korea's missile programme. But the incomplete elements of that deal are the toughest: how to verify that North Korea is keeping its word. As Mr Bush told Mr Kim this week, effective checks might not be accepted by such a secretive regime.

Meanwhile, the implementation of a 1994 agreement that ended North Korea's plutonium production in return for two new western-designed nuclear reactors and interim supplies of heavy fuel oil is badly behind schedule, largely as a result of North Korea's obstructive behaviour: the two new reactors were meant to start producing electricity by 2003, but the first concrete will not be poured before the end of next year. And it gets harder each year for KEDO, the consortium masterminding the project, which is led

by America but includes South Korea, Japan and the European Union, to find the money for the interim fuel deliveries. Some of Mr Bush's advisers want to explore substituting conventional power plants for the nuclear ones promised, but South Korea opposes that idea. North Korea, while demanding compensation for the project's delay, is pressing South Korea to supply now.

Mr Kim seems tempted by that suggestion, though it could cause a real bust-up with America. North Korea has shown little enough inclination to come clean about its past plutonium-making, though it is obliged to do so before any of the nuclear components of the new reactors are delivered. If South Korea steps in to provide the missing electricity, the North would have much less incentive to do so.

There may be a way of linking electricity supplies to convincing steps by North Korea to reduce the military threat, nuclear and conventional, that it poses. But if there is, Mr Kim and Mr Bush did not find it this week.

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Hitting the Tigers in their pockets

Mar 8th 2001 | COLOMBO
From The Economist print edition

AP

Solheim the postman

THE Tamil Tigers face a new threat, possibly more lethal than the Sri Lankan army that has been fighting them for the past 17 years. Last week's decision by Britain to name them as a terrorist organisation to be banned from running its overseas headquarters in London may deprive the Tigers of an important source of money. The London "political wing" controls branches in other European countries, the United States, Canada and Australia. Between them they raise money for the Tigers estimated at $450m-500m a year. Much of it is used to keep the Tigers supplied with arms.

With its tradition of providing asylum for those in danger of persecution, Britain has been reluctant to heed pleas from the Sri Lankan government to ban the Tigers. But it is no longer willing to provide a base for warfare against a democratic country in which Britain was the colonial power. The Liberation Tigers of Tamil Eelam are one of 21 organisations named in connection with the Terrorism Act 2000, passed by the British Parliament in July last year. The act takes into account United Nations conventions on terrorism. Parliament has to approve the naming of the 21, though this is likely to be only a formality. But a legal challenge could delay any further action. The United States Supreme Court this week also upheld a ban on the movement in that country.

In Sri Lanka, the measure has been hailed in pro-government newspapers as a diplomatic triumph for President Chandrika Kumaratunga, who has not had much success lately. As finance minister, she is blamed for rising inflation and trade-union militancy, both triggered by the floating of the Sri Lankan rupee. So the British decision, and its approval by Buddhist monks (Buddhists make up 75% of the island's population), is a bonus.

The Norwegians, though, who have been trying to bring together Mrs Kumaratunga and the Tigers' leader, Velupillai Prabhakaran, are a bit miffed by the British move. On his visit to Colombo on March 3rd, Erik Solheim, the Norwegian envoy, no longer spoke of mediating. He was merely "a postman" between the two sides. Even before the British turned on the Tigers, the Norwegians seemed reluctant peacemakers, drawn in partly in the hope of getting Sri Lanka's support for Norway's successful bid to become a temporary member of the UN Security Council. Norway's role even as postman may have run its course.

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Japan

Diminishing returns

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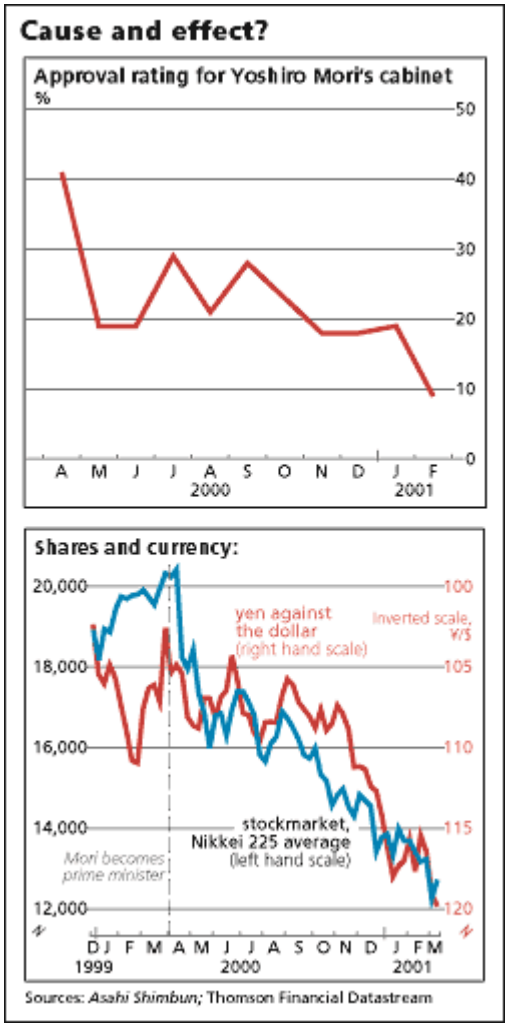
From The Economist print edition

IT IS hardly surprising that the Japanese have become wary of their government's efforts to revive the economy. Since the beginning of the 1990s, when growth stalled, the politicians have drawn up no fewer than 13 rescue packages. None has had any lasting effect save the creation of a mountain of public debt, prompting the finance minister to say this week that Japan's public finances were "quite near a state of collapse". Plans to rescue Japan's banks have come and gone, and the banks look as sickly as ever. The stockmarket gets fresh policies for its reinvigoration every year, yet share prices keep falling. Recently, the government has been making new efforts to shore up the economy, with not one set of emergency measures but three, two of which were due to be revealed on March 9th.

The government's latest initiatives are at least an improvement on what has gone before. The debate began with talk of using Japan's vast post-office savings to prop up the stockmarket: the authorities might use them to buy shares directly—a return to the notorious "price-keeping operations" of the early 1990s. But these crude methods no longer find favour with the public, and have been dropped. Instead, there are plans to broaden demand by giving tax incentives to individual investors, just 7% of whose money is invested in the stockmarket, much less than in, say, America or Britain.



Those who grumble that such policies treat the symptoms not the disease may be encouraged by the second set of measures, which aims to tackle the banks. One of the many weaknesses of the effort to clean up the banks has been the futile attempt to do it painlessly. This has merely prolonged their agony and that of their borrowers in the building, property and retail industries. The government's new policy looks more brutal: there will be a full disposal of bad debts by next March.

This is sure to do something nasty to the economy, which is already weak. One bank, Goldman Sachs, guesses that the government's plans for the banks would shave a full 1.5% off economic growth and put more than 300,000 people out of work. So the central bank, the Bank of Japan, stands ready with a third economic initiative: easier money. This could involve cutting interest rates, driving the yen lower, or buying government bonds, land or other assets.

One reason for the multiplicity of measures is the traditional desire for a consensual approach, which the incumbent prime minister, Yoshiro Mori, has tried but failed to change. It means that policies emerge messily in public rather than being put together neatly in private. Decisions take too long, especially on urgent problems such as the banks and the economy, which has weakened dramatically in the past few weeks.

The consensual approach also means that everyone has a go at policymaking, with unpredictable effects. The policies to support the stockmarket, for instance, come from Mr Mori's party, the Liberal Democrats (LDP). The banking initiative is from the cabinet, although not from Mr Mori himself but one of his ministers, Hakuo Yanagisawa. The Bank of Japan, meanwhile, wants to support Mr Yanagisawa with looser monetary policy, but, like everyone else, is unsure about the LDP's attitudes to the plan, and so is merely hinting at its intentions. Meanwhile, the banks themselves are pouring cold water on the whole idea. Mr Mori has a new council under his direct control to co-ordinate such policy matters. Officials at the Bank of Japan say it is not working as it should.

The confusion all stems from one basic problem: a lack of leadership. It was clear from the start of his administration that Mr Mori was not cut out to lead. Despite comfortably surviving a vote of no confidence in parliament this week, his third in less than a year, the poor man may soon be returned to the backbenches. Reports suggest he may at last have come round to the idea of resigning, perhaps next week.

Mr Mori's exit would probably provide short-term relief to the stockmarket. With him would go Shizuka Kamei, the LDP's policy chief, whose batty ideas do most to discredit the government's policies at the moment. Each of Mr Mori's three or four potential successors, meanwhile, offers something to cheer the market, whether it be a better grip on the party or a fresh idea about reform. But there are no obvious leaders who could get the government's grand economic plans off the drawing-board at last. In the meantime, more emergency packages seem likely.

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Malaysia

Making it easy for Mahathir

Mar 8th 2001 | KUALA LUMPUR
From The Economist print edition

Get article background

DO MALAYSIA'S opposition parties really hope to run the country one day? Their recent behaviour hardly makes them seem serious. Mahathir Mohamad, who has ruled Malaysia since 1981, is beset by a disgruntled Malay majority and criticism in his own ranks. He continues to offer opponents open goals, such as his decision last week to restart a controversial dam in East Malaysia, on terms that make less sense than the original ones. Yet instead of articulating a convincing alternative government, two of the three main opposition parties are caught up in civil war. With enemies like these, Dr Mahathir can afford to have few friends.

The row in the opposition broke out in late February, when several disgruntled cast-offs from the Democratic Action Party (DAP) applied to join its coalition partner, the Keadilan party of Wan Azizah Ismail, wife of Dr Mahathir's imprisoned former deputy, Anwar Ibrahim. The former DAP members—all from Penang, a DAP stronghold—resigned after a row with its autocratic leader, Lim Kit Siang. Although party members change loyalties all the time in Malaysia, the latest migration has left many DAP members livid.

By accepting the troublemakers, they complain, Keadilan has broken an agreement among members of the opposition alliance not to accept each other's renegades. Mr Lim has vowed to boycott events that are jointly sponsored by the DAP and Keadilan. Behind the personalities and the bickering lies a fundamental rift between the parties—one that threatens the entire logic of the opposition alliance.

That alliance was formed to counter the ethnic arithmetic of the ruling coalition, which has been led by the United Malays National Organisation (UMNO) since independence in 1957, mostly in coalition with the Malay Chinese Association and other ethnic groups. In the 1999 general election, the newly created Keadilan party presented itself as the glue between its two partners—the Chinese-based DAP and the Islamic Party of Malaysia (PAS), which do not otherwise have much in common. In the event, Keadilan won fewer seats than either the DAP or PAS. But its leaders remain convinced that it is the linchpin of the alliance, and that it must increase its role if the opposition is to take power. Such ideas do not sit well with the DAP, Malaysia's biggest opposition party until the 1999 election, when it was supplanted by PAS, the main beneficiary of all those unhappy Malays.

Ironically, one of the most troublesome events for the opposition arose from a victory, in a prominent by-election in Lunas late last year. By picking up a local-assembly seat in Dr Mahathir's home state of Kedah, the opposition proved that it could put up a good fight in a well-defended UMNO district, and showed Dr Mahathir to be a growing liability. But before they took on UMNO, Keadilan and the DAP had fought a bitter battle between themselves over which candidate to run, which Keadilan eventually won.

Far from uniting them, the opposition's victory has set them at each other throats. Keadilan members now argue that they have proved themselves right. They say that their moderate Malay base and their multi-ethnic ambitions, make theirs the ideal party to take on UMNO. DAP leaders counter that it was Dr Mahathir's weakness and the appeal of the alliance as a whole that allowed it to win Lunas. Lim Guan Eng, the DAP leader's son, insists that the party will fight hard over any division of seats in the future. "We are ready to take Keadilan on in a three-way fight—anywhere," he says. "Then let's see who gets the most votes." The DAP looks set to fight Keadilan in elections in Sarawak later this year.

Dr Mahathir could hardly have hoped for a better gift. A huge number of young Malaysians will be eligible to vote for the first time in the next general election. A disciplined opposition might hope to win another big chunk of UMNO seats and weaken the ruling coalition. But perhaps UMNO's opponents are happy to remain out of power.

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Caspian pipedreams no longer

Mar 8th 2001 | ASTANA
From The Economist print edition

THE Caspian Sea and its surroundings are believed to contain such quantities of oil that oilmen like to call it the second Kuwait. But the cost of building pipelines to get the black stuff from remote Central Asia to Europe, the Americas and the Far East, as well as the complex politics involved, has led to an epic battle of consortiums and governments that has been going on for a decade.

Last week, it seemed that the United States had finally come out on top. The governments of Azerbaijan, Georgia, Kazakhstan and Turkey signed a memorandum of understanding in the Kazakhstani capital Astana on a proposed 1,730km (1,075-mile) pipeline, to run from the Azerbaijani capital Baku via Georgia's capital Tbilisi to Turkey's Mediterranean port of Ceyhan. The document itself was far from a final agreement: it merely provides a legal framework for oil producers in Kazakhstan to join the project. But it was an indicator of the growing momentum of American plans for a pipeline bypassing both Russia and Iran. Once on the verge of collapse, they now look secure.

There are several reasons for the turnaround. One is that the shareholders in Azerbaijan's main foreign oil consortium AIOC, led by Britain's BP, decided last October to back the pipeline, likely to cost around $2.5 billion, and therefore to start a six-month basic engineering study. The plan received another boost in February when Chevron announced its interest in taking part in both the study and the building project. Chevron has a 50% stake in Kazakhstan's giant Tengiz oilfield and 30% in an Azerbaijani offshore oilfield.

Another factor has been the discovery of oil in the Kazakh sector of the Caspian Sea last summer, where the Offshore Kazakhstan International Operating Company has been drilling. It is the world's largest oil find in 30 years. Kazakhstan's president, Nursultan Nazarbaev, told Elizabeth Jones, America's envoy to the Caspian, last week that the Baku-Ceyhan pipeline would provide an export route for early oil from Kashagan, where production is due to start in 2005.

Then there are America's sanctions against Iran. The oil companies were hoping that the sanctions, due to end on August 5th, would not be renewed, making feasible a shorter and cheaper pipeline through Iran to the Gulf. That now seems unlikely. Iran has not provided a reason for America to lift sanctions, says a western diplomat. It seems preoccupied with internal problems, though its president goes to Moscow next week (see article).

A a newly-built pipeline, connecting Tengiz with the Russian Black Sea port Novorossiisk, is due to start operations this summer and will be Kazakhstan's primary export route, but it is too small for all the oil that will be produced in the coming years. And since it will go through Russia, America thinks that Kazakhstan, Azerbaijan and Georgia should have a route safe from the whims of their former coloniser.

Russia, of course, has a different view and is publicly critical of the Baku-Ceyhan pipeline. But Russian oil

companies privately express no such hostility. After all, should they find more oil in the Caspian, they would need an extra pipeline, too.

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Fiji

Stormy weather

Mar 8th 2001 | SUVA
From The Economist print edition

Get article background

THE politics of Fiji, never simple, took a turn for the worse this week. This is the small country in the South Pacific where in May last year a group of rebels opposed to the government occupied Parliament and made prisoners of the prime minister, Mahendra Chaudhry, and most of his cabinet. Since then the prisoners have been freed, the rebel leader, George Speight, has been jailed awaiting trial, and an "interim" government has been set up.

On March 1st, the interim government was ruled by Fiji's Court of Appeal to be illegal and this week it said it would resign. Could Mr Chaudhry now rightfully claim his old job back? At first he did, but on March 7th he offered his resignation as prime minister to the president and asked him to dissolve Parliament and call a general election.

Mr Chaudhry is Fiji's first prime minister of Indian descent. But his popularity has waned since his election in May 1999. His opponents in the winning coalition led by his Fiji Labour Party claim he has inflamed ethnic tensions. Conflict between indigenous Fijians and the descendants of Indians brought to the islands to work in the sugar plantations in the 19th century lay behind last year's rebellion. The Indo-Fijians now make up some 44% of the population of 800,000 and dominate Fiji's business life.

Mr Chaudhry's main rival, Tupeni Baba, an ethnic Fijian, was deputy prime minister and is a Labour member of Parliament. As nature, in the form of a hurricane lashing the islands, added to the confusion this week, Mr Baba called for a "government of national unity". Mr Chaudhry, however, refuses to serve in an administration that includes supporters of the rebellion. Just as it looked as though his cards were played out, the wily Mr Chaudhry has caught his opponents off guard by tendering his resignation. The national interest would best be served by elections, he said.

Mr Baba disagrees. The country is not ready for such an unsettling event, in his view. Fijians need time to consider the many concerns raised by the tumultuous events of the past ten months. The largest grouping of ethnic-Fijian parties, the Fijian Forum, has given the dispute an anarchic twist by saying that it does not accept the ruling of the Court of Appeal against the interim government. The Fijian Forum includes extreme nationalists as well as some supporters of Mr Speight. It is deeply opposed to the present constitution, which was adopted in 1997 and gives equal rights to the Indo-Fijians and the ethnic Fijians.

The Great Council of Chiefs, a conclave of indigenous rulers, one of whose tasks is to choose the country's president, is furious at the failure of the court to approve the interim government. The president, Ratu Josefa Iloilo, has asked the interim government to stay in power. But he may yet be replaced. The most likely outcome is that Fiji will face fresh elections soon.

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Nepal's overburdened women

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From The Economist print edition

THE lot of a woman is rarely an easy one in Asia. She is likely to have less education, money or power than her male counterpart. In the mountain kingdom of Nepal it is particularly tough, especially if she is poor. Nepal ranks low in the league tables on maternal health, female literacy and the role of women in public life. Human Rights Watch, an American group, recently reported that tens of thousands of Nepalese women are forced into prostitution in neighbouring India. But, just as parliament was setting about changing things, the drive for reform has stalled.

At the root of many inequalities is the right to own and inherit land. In this, women are hard done by. Nepalese civil law allows a woman to inherit property from her father only if she remains unmarried to the age of 35. A widow may inherit only if her marriage lasts 15 years or more, and the few rights of divorced women are widely ignored. The law is distilled from rural custom and Hindu scripture, and generally holds that land is owned collectively by families and then passed to the next generation, as represented by sons.

But, after the Supreme Court declared many of the statutes unconstitutional, a set of reforms was put before parliament. These give some statutory property rights to women, though stopping short of allowing parents to leave property to whomsoever they choose. Sadly, parliament has been frozen for weeks by accusations of government corruption.

That delay suits those who fear reform. To many in Nepal, where good land is scarce, the idea of splitting up the family farm is abhorrent. Some fear that the changes will encourage siblings to take land squabbles to court, or that the Indian custom of dowry, whereby men receive money or property when they marry, will be adopted.

But even where laws exist to protect women's interests, they are often ignored. Though polygamy has been illegal since 1963, many men take additional wives if the first union fails to produce a son. Such practices must change, say activists. One of these, Sapna Pradhan Mallah, believes that even incremental changes to the civil law will improve things and give women in Nepal a glimpse of equality. "In our worst-off rural areas," she says, "wives are treated like slaves or pack animals. The smallest improvement in that is worth whatever social disruption it causes."

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Oh no, not war in Macedonia as well

Mar 8th 2001 | SKOPJE AND PRISTINA
From The Economist print edition

Ethnic-Albanian guerrillas are spreading gunfire into Macedonia, and have now drawn it upon themselves from NATO

FRESH trouble was brewing in the Balkans this week, inside Kosovo and on its border with Macedonia. The troublemakers in both cases: ethnic-Albanian guerrillas.

AP

Macedonia honours its dead soldiers

The flashpoint this week was Tanusevci, a Macedonian mountain village near the border with Kosovo. It had been seized earlier by armed ethnic-Albanian gunmen from across the border. At first, President Boris Trajkovski of Macedonia, on NATO's advice, reacted with un-Balkan restraint, though appealing for western assistance. That changed, though, when three Macedonian soldiers were killed on March 4th, two when their vehicle hit a landmine, a third by a sniper's bullet. A day later, with the alliance's approval, a heavy barrage from the Macedonian army drove the fighters back into Kosovo. And then the assistance came: on March 8th, NATO troops, backed by helicopters, went into the village. But only into a part that straggles into Kosovo, said NATO. Across the border, said a rival version. It did not matter much: Macedonia's government was happy, and confrontation was on.

NATO and its peacekeeping force, known as Kfor, arrived in Kosovo two years ago as liberators of the ethnic Albanians there, after an 11-week campaign against their Serb oppressors. But they have been increasingly needled by the guerrillas. The guerrillas' earlier removal from Tanusevci had been closely watched, and at least indirectly aided, by Kfor's local contingent, which happens to be American. With their helicopters and night-vision equipment, troops of the 82nd Airborne regiment watched the fighters scurry over the border to houses in Kosovo and exchange their black uniforms for civilian clothes. March 7th brought a clash between the American troops and a small guerrilla group. The western action on the border was the logical next step.

Meanwhile, NATO has agreed to allow Yugoslav forces battling with ethnic-Albanian guerrillas in Serbia itself to come some distance into a strip of land just across Kosovo's eastern edge that was demilitarised under the June 1999 accord that ended NATO's campaign against Yugoslavia.

NATO's decision to get tougher on ethnic-Albanian extremism did not come a moment too soon, say officials in Macedonia, where a Slav majority co-exists uneasily—but so far peacefully, on the whole—with an Albanian minority of 30-35%. Nor should the skirmish at Tanusevci be viewed as an isolated incident, the officials add gloomily.

The activities of ethnic-Albanian guerrillas have caused an exodus of civilians from several other isolated, often snowbound, villages near the border. It appears that veterans of the (supposedly disbanded) Kosovo Liberation Army have set up a Macedonian offshoot, similar to the extremist groups active in the Presevo valley, part of the demilitarised strip. Three Yugoslav soldiers were killed by a landmine in that area on March 7th.

Finding recruits for a new ragtag army, bent on making trouble in Macedonia, could be all too easy. Although it has spawned many flourishing small businesses—legal and otherwise—Macedonia's Albanian community has an unemployment rate of more than 60%, compared with the national average of about half that.

To ward off further incursions from Kosovo, Macedonia wants NATO to organise stronger border patrols, and keep them patrolling. Greece, whose peacekeepers are deployed in southern Kosovo alongside the Americans and Poles, has said it will contribute. Bulgaria, a would-be NATO member with close ethnic

and linguistic ties to Macedonia's Slavic majority, has also offered to send military assistance.

The Macedonian authorities for a time closed their northern border to all but Macedonian citizens returning home. Reservists are being called up to boost the size—if not, maybe, the limited skills—of Macedonia's small and largely conscript army. Hundreds of policemen armed with automatic weapons guard the streets of Tetovo, the biggest ethnic-Albanian town, and Skopje, the country's capital.

Hopes are still high in Skopje that a serious outbreak of ethnic violence can be avoided. Because the Democratic Party of Albanians—the community's main political voice—has been asserting itself recently in the country's ruling coalition, ethnic Albanians have been enjoying better access to jobs and bank loans. But both the DPA and the ruling VMRO (an old Slavic-nationalist movement which is now relatively moderate and market-minded) have internal problems that may distract them from the effort to keep the country stable.

Ljubco Georgievski, the prime minister, is enmeshed in a telephone-tapping scandal. His powerful interior minister, Dosta Dimovska, is struggling to retain her job after the opposition Social Democrats handed over tapes, recorded by her ministry, of conversations involving cabinet members, western diplomats and even Mr Trajkovski himself. Divisions are appearing in the DPA, because Arben Xhaferi, its sensible leader, is in poor health; and some of his rivals have a weakness for the notorious Balkan cigarette-smuggling gangs that prefer the region's borders to be loosely guarded.

In Kosovo, meanwhile, politicians who speak for the ethnic-Albanian majority there have been distancing themselves from extremism, but also warning western governments not to make common cause with their Slavic rivals. One of them condemned NATO's plans to give Yugoslav forces a slightly freer hand as a "provocation" that could plunge the region into fresh conflict.

There is one small hopeful sign: the government of Albania, though its writ hardly runs in the country's wild northern fringe, has declared its respect for the territorial integrity of Macedonia, implicitly renouncing any interest in the creation of a "greater Albania". But will such sensible statements dissuade the jobless young men of Tetovo from dreaming their nationalist dreams? Or from taking up arms to pursue them?

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Ukraine

Power wins

Mar 8th 2001
From The Economist print edition

Get article background

Reuters

Kiev: no campsite

AN APATHETIC, cynical population, plus a heavy-handed ruling elite that brushes off even the most corrosive scandals, is an unlikely recipe for a revolution. So it has proved in Ukraine. The opposition had hoped to profit from its recent release of tape-recordings showing President Leonid Kuchma—if they are authentic—to be utterly ruthless and foul-mouthed with it. Surely these would prompt enough outrage to force him to resign? Not so. In a few brisk minutes on March 1st, police cleared away a bunch of protesters who had been camping in Kiev's main street, the only open sign of public discontent.

The opposition's last hope is to release some even more damning tapes, if they exist, from the hundreds of hours' worth it has. But even that might not work. Mr Kuchma survives not through popularity but by patronage, manipulation and force. The battle now is about the future of the government and its head, Viktor Yushchenko.

The presidential camp has already scored two big victories. One was putting a deputy prime minister, Yulia Timoshenko, in jail. She had been trying to make big consumers of energy pay in cash. That annoyed the powerful tycoons around Mr Kuchma. The other was to nobble Mr Yushchenko himself. Reformists and foreign governments saw him as a potential president. He was arm-twisted into signing a vituperative letter denouncing the protesters, who include respected cultural figures and former dissidents, as fascists.

Mr Yushchenko's government, despite sniping from Mr Kuchma, was until recently the most effective and reform-minded in Ukraine's sorry post-independence story. Although there has been little structural change and the country is desperately poor (even compared with Russia), the economy is stable and growing, and the state is paying its debts, at home and abroad. But the presidential camp now wants a tighter hold on power. Mr Kuchma says that ministers and senior officials who will not publicly denounce his critics must go. His own people are getting ready to replace them.

Mr Yushchenko himself faces a no-confidence vote in parliament on April 5th. Having sacrificed his friends to placate his enemies, his position looks weak. One reason for keeping him on is to provide a figleaf of credibility to foreigners. Without him, Ukraine will find it hard to win more money from the IMF. His own thinking is that economics matters much more than politics, and that by swallowing hard and staying put as long as possible he can still serve his country better than by resigning. The cost to his reputation is appalling. Many Ukrainians think he was blackmailed, or threatened.

Other candidates for the prime ministership are circling. One is Viktor Medvedchuk, a deputy speaker of parliament and in private life a tycoon closely tied to Mr Kuchma. Another is the head of the tax service, Mykola Azarov, one of the president's toughest and most powerful pals. He has just become leader (temporarily, he says) of a new political party. Mr Kuchma's own position among his chums is weaker since the tapes scandal. If he resigns, the prime minister takes over as acting president. That would be a rich prize for a determined courtier.

During the hullabaloo of recent months, ruthless and well-connected Ukrainians have stepped up their looting of the country, often in cahoots with their counterparts in Russia. A change in the government would make that even easier. Western countries, which badly want Ukraine to become a better neighbour, would find it even harder to help. The country is already a big source of smuggled people, drugs and weapons. For all his brave talk, Mr Yushchenko has barely scratched the incompetent, corrupt, Soviet-style bureaucracy that stifles economic reform and tolerates crime. As in Russia, there is hope for the day when—if—a new post-Soviet generation takes power. But that still looks a long way off.

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Poland

A third voice

Mar 8th 2001 | WARSAW
From The Economist print edition

EARLY this year, Poland's ex-communist Social Democrats looked a shoo-in to win the general election expected in the autumn. Pollsters put them 30 percentage points ahead of the sickly Solidarity government led by Jerzy Buzek. No more. The Social Democrats are still well ahead, but for the first time in two years they are losing ground, thanks to a new liberal-conservative party that calls itself the Civic Platform, or plain Platform, which is bidding spiritedly for the middle ground. If it can keep up its momentum—opinion polls suggest that a fifth of the voters already back it—and if the right does not implode completely, it might hold the balance of power in a new parliament.

Platform is the brainchild of Andrzej Olechowski, a former foreign minister who ran a good second, without any party support, to the incumbent Social Democrat, Aleksander Kwasniewski, in last year's presidential election. He is making an impact because the assorted groups under the Solidarity umbrella and the Freedom Union are in disarray, their coalition having broken up last summer. Solidarity is ruling with a minority of seats in parliament. Many middle-class Poles, not least businessmen, now look to Mr Olechowski for a "third way" between the old left and the Roman Catholic traditionalists and nationalists on the right.

At first Mr Olechowski hesitated to launch a new party. But in late January he teamed up with two other prominent Poles: Donald Tusk, a rising star in the Freedom Union, who had lost a bitter battle for that party's leadership; and parliament's popular speaker, Maciej Plazynski, who had left Solidarity after trying and failing to supplant its leader. Mr Olechowski will not compete in this year's election, and will let Mr Plazynski head Platform in parliament. "I'm not a party animal," he says. Cynics note that it would do him no harm to have been outside any parliamentary bickering when the next presidential election comes round, in 2005.

Platform is worrying Leszek Miller, the Social Democratic leader. If in response to it he woos the middle-of-the-road voter too hard, he may annoy loyal socialists. He has already appalled modernisers in his party—and foreign investors—by hinting that he would sooner embrace the protectionist and backward-looking Peasants' Party than the Freedom Union in a future coalition.

But the Freedom Union and Solidarity look to be the real losers. Many followers of Mr Tusk who were shoved aside after his leadership bid failed have already defected to the new party, and Freedom may struggle even to cross the 5%-of-the-vote threshold for getting seats in parliament. Mr Olechowski has been courting Solidarity figures too, and even that party's doughtiest supporters doubt that its fortunes will revive.

Platform's policies are vague. With unemployment back to 16%, its highest for six years, Mr Olechowski says he wants to "release the Polish people's energy" by loosening labour laws, wiring up rural Poland, and bringing in a flat rate of income tax. That at least offers ammunition against the Social Democrats, who some suspect will retreat to old socialist remedies for unemployment.

Just what Mr Olechowski's blather about "civil society" amounts to, who can say? But maybe who cares? Poles like showmen and he is a master of the soundbite, unlike the Social Democrats' dour leader. Moreover, he has a media-savvy campaign manager in Pawel Piskorski, the mayor of Warsaw, another ex-Freedom man. Poland has taken to free-marketry better than some other ex-communist states. Here, maybe, is a party to match: one that knows how to sell, without worrying too much what.

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Charlemagne

Jaime Mayor Oreja, Spain's tough Basque

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HE HAS just stood down from one of Spain's toughest jobs: that of interior minister, heading the fight—on all Europe's behalf, he insists—against illegal immigration and, harder still, against Basque-separatist terrorism. But only to take up another just as difficult: "Don Tranquilo" (Mister Calm), as Jaime Mayor Oreja's staff call him, is the choice of Spain's governing People's Party to lead its challenge in the Basque regional elections on May 13th and then, the PP hopes, to head a non-nationalist regional government there.

Calm he may be, brave he must be. Mr Mayor Oreja, a Basque himself, will now become an even more attractive target for ETA's gunmen. "I'd no choice," he says. "How could I face members of my party who have withstood threats and constant attacks from ETA since we came to power [in 1996], if I weren't willing to do the same myself?" His decision will do him no harm politically. In opinion polls, Mr Mayor Oreja is rated top of Jose Maria Aznar's cabinet team, and he is considered a possible successor when the prime minister steps down, as Mr Aznar has said he will, at the end of his current term, in 2004. Moreover, Mr Mayor Oreja's calm coexists with a steely, almost obsessive, determination to push through policies that deeply divide Basques. He insists that ETA can be defeated through concerted police action. He also argues that the mainstream, non-violent, Basque Nationalist Party (PNV) must be ousted from the regional administration, which it has controlled—and, he maintains, abused—since Spain's system of regional governments was set up some 20 years ago.

After General Franco's death, Madrid politicians deferred to the PNV, feeling compensation was due for the dictator's crude repression of Basque nationalism. Now, Mr Mayor Oreja argues, "the time for guilt is over". As he runs through the past century of Basque history, when the nationalist movement was cemented after wars between rival pretenders to the Spanish crown, he insists that Basques now enjoy more political freedom than ever before. They can pursue their aims, independence included, peacefully and through existing mechanisms; phooey to the PNV's (and ETA's) long-standing demand for the "right to self-determination".

When ETA declared a ceasefire in September 1998, ordinary Basques welcomed the news with relief. Mr Mayor Oreja, in contrast, insisted from the start that this was a ruse to gain political concessions. He won few friends. Mr Aznar took the advice of other counsellors, familiar with Northern Ireland's peace process, who advocated talking to ETA. But the government offered no concessions of political substance, and the brief talks got nowhere. When ETA ended the truce in December 1999, and soon started to kill again, Mr Mayor Oreja felt vindicated. But many Basque nationalists believed he had sabotaged what they considered a real chance for lasting peace. To such people, Mr Mayor Oreja, born in 1951 in the Basque resort of San Sebastian, is a traitor: a Basque who refuses to speak Basque, a member of the bourgeoisie who has sold out to Spain. ETA has put him top of its hit-list.

The risk that means to his wife and their four children is the one thing he regrets about his political vocation. Family is important to him. It was his uncle Marcelino, until recently an EU commissioner, who drew him into politics in the late 1970s, when he was a promising law student. Spain was in the throes of transition to democracy, and candidates were needed for the Union of the Democratic Centre (UCD), the new Christian-democratic party. Mr Mayor Oreja is the only survivor of a tight group of four friends who worked for the UCD. The others were all killed by ETA; one only hours after he had escorted Mr Mayor Oreja's then girlfriend, Isabel, now his wife, home after an evening at the cinema. Mr Mayor Oreja pressed on, leaving Basque politics only briefly, when the UCD disintegrated. In 1989, Mr Aznar persuaded him to refound the centre-right there, on behalf of its replacement, the PP.

Religion is the other linchpin of Mr Mayor Oreja's life. "He is more Christian than democrat," says Carmen Gurruchaga, a Basque journalist who knows him well. Even as a youth he was devout, says one of his teachers at the elite Marianist school he attended. Mr Mayor Oreja insists he experiences no moral doubts over his tough stand against the terrorists, not even as he comforts the families of their victims. But he does admit to a sense of failed responsibility during those periods when ETA has gained the upper hand over the police. He makes frequent reference to the precise number of people killed during his tenure as interior minister, 47. It is far fewer than in the early 1980s, when more than 100 people were killed in a single year, but still, he is very conscious, too many. One notorious killing above all sticks in his mind: that of Miguel Angel Blanco, a young PP councillor, who was kidnapped in July 1997 and killed 48 hours later after the government had rejected ETA's demand that all ETA prisoners should be moved to jails in the Basque country. "It was murder in slow motion," says Mr Mayor Oreja. The murder brought millions of Spaniards, including Basques, on to the streets demanding an end to ETA violence. They have continued to protest that way after every subsequent killing; clear proof, says Mr Mayor Oreja, that they have had enough of the climate of fear created by ETA—with, he claims (and the PNV fiercely denies), the tacit backing of the mainstream nationalists.

Opinion polls suggest that the PP may win the most votes in the Basque region, and perhaps indeed be able, given Socialist backing, to form a government. To be the regional premier of all Basques, not just those who see themselves as Spanish, would be the biggest test of Mr Mayor Oreja's career. His priority, he says, would be to restore freedom to a region that lost it under Franco and then again, in his version, under the PNV. He reminds sceptics that he was strongly in favour of Basque devolution.

And if the PP does not win? That would not necessarily scupper his chances of succeeding Mr Aznar in the prime ministership. Win or lose, Mr Mayor Oreja will have demonstrated the quality Spaniards value most in their politicians: *cojones*, balls.

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France

Far-right rumbles

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From The Economist print edition

Get article background

AFP

Bompard rebranded

IS THE far right finished, just a flash in France's political pan? Not if you listen to Jacques Bompard, mayor of Orange: of course he will be re-elected, if not in the first round of municipal voting on March 11th with an absolute majority, then certainly in the second round a week later, "and it'll give me a lot of satisfaction, after the attacks I've suffered from all sides."

Elsewhere, the reaction is more likely to be dismay. The 16,000 voters of Orange, a small town in Provence known to tourists for its Roman amphitheatre and Romanesque cathedral, will have chosen, again, a founding member and leading figure of the National Front (FN), a party proud of its racism and unabashedly narrow nationalism.

Opinion polls suggest that France's three other far-right mayors—Jean-Marie Le Chevallier in Toulon, Catherine Mégret in Vitrolles and Daniel Simonpieri in Marignane—will lose. That would make victory especially sweet for Mr Bompard: he is the only one of this Provençal quartet to have remained loyal to the FN and its leader, Jean-Marie Le Pen. The others followed Bruno Mégret, husband of Catherine, when he split with Mr Le Pen and in 1999 formed a rival far-right party.

Yet is Mr Bompard counting his chickens a little early? The extreme right is not just divided but in retreat. In the 1994 elections to the European Parliament (where Mr Le Pen was a vociferously anti-EU member), the FN won 10.5% of French votes. It took 15% in the French regional elections of 1998. But then, in the European elections of 1999, it and its new rival shared a mere 9%.

Why? Because of the split, in part. But more deeply because the basic ingredients of its message—native-born citizens ("the real French") should have priority in jobs, housing, education and health care, traditional politicians are all corrupt—are less appetising now that unemployment is falling and the government has been run for four years by a manifestly strait-laced Protestant, Lionel Jospin. Moreover, accusations of sleaze have spoiled the image of Mr Le Chevallier in Toulon, while in Vitrolles Mrs Mégret has fallen foul of the courts for trying to offer a "birth allowance" to new parents of French or European Union origin only.

Mr Bompard has surely sensed the change. In 1995 he headed an FN list of candidates; now his list is called "Orange for You", with no mention of his continued support for the FN. Why? Mr Bompard replies that now he has a balance-sheet of his performance—sound finances, lower taxes and higher investment—to present to the voters and "the municipal elections are not a battle of political ideologies."

Tosh, say his opponents. The Socialists talk of taxes that are higher than in comparable French towns. Alain Agostini, leading an alliance of conservative parties, claims that Mr Bompard has concentrated his efforts on the town centre, neglecting the infrastructure needs of Orange as a whole. Local voluntary and cultural associations complain that the mayor's extreme views (at one point books by "foreign" writers were removed from the municipal library) have isolated Orange and deprived it of national and regional subsidies.

Yet many small businessmen, including those who will not vote for him, praise Mr Bompard's efficiency. He has an incumbent's momentum and power of patronage. His list of candidates neatly encompasses all sectors of the electorate except, you guessed, people of North African origin. And he faces four rival lists. In 1995, with both left and right split, Mr Bompard needed only 36% of the vote to win a three-way contest in the second round. He could do it again.

No way, says Mr Agostini: in the second round, he and Claude Béroud, who leads a mostly Socialist list, will join in a “republican front” to defeat Mr Bompard. Anti-democratic, complains the mayor, recalling that when he stood in Avignon for the National Assembly in 1993 it was an alliance of left and right that foiled him.

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The European Union

Liberalise? Regulate? Both

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The European Union talks a lot about reform. Seen any lately?

LIKE lovers, European Union leaders use place-names as codes for past rendezvous. “Maastricht” recalls the joys of monetary union, “Nice” a nasty week-end of bickering last December that ended in sullen agreement on institutional reform. Later this month the EU’s 15 leaders will meet in Stockholm. For what? Well, it is all to do with building on the spirit of “Lisbon”.

At that summit last year, the EU 15 swore to make theirs “the most competitive and knowledge-based economy in the world” by 2010. Flannel, jeered their critics. But the EU’s choice of rhetoric matters. To its free-marketeers—notably, Britain and Spain—a commitment to economic reform is a step towards control of the agenda. For there is a rival one, backed notably by Belgium and France, less concerned with economic reform and more with building a “social Europe” in which workers’ rights and extensive welfare systems are emphasised.

At Lisbon, the 15 leaders agreed to open telecoms, transport, postal services and energy to competition; to integrate financial markets; to set targets for job-creation; to cut red tape; to make it easier for EU citizens moving country to have their qualifications respected. And that was just for starters, said the enthusiasts. From now on, every spring summit would be dedicated to promoting and monitoring economic reform.

It is a rosy picture, but only half true. Ask liberalisers to point to reforms that have actually happened and nearly always they will offer the same reply: “unbundling the local loop”—jargon for a recent EU directive requiring telecoms companies to allow competition in local telephone and Internet services. The EU 15 signed up to this, perhaps unknowingly, in Lisbon, so the Eurocrats had the power to put it through.

And what else? Hm, er, well. What about all those high-sounding reports and studies that have been commissioned? And after all, “Lisbon” is a ten-year process, so you don’t expect everything at once, do you?

The reality, though, is that many of the reforms approved there will be hard to push through. France’s powerful public-sector unions will make its government dig in its heels against the possibility of real foreign competition in energy and rail services. And even in Britain, Tony Blair, for all his liberalising slogans, is going slow over competition in postal services.

There’s worse, though, than trouble getting the free-market agenda enacted. Parts of the EU’s agenda are actually anti-market. Proposed changes to European labour laws—which may not even be discussed in Stockholm—are likely to make European economies less flexible, as well as riding roughshod over the much-abused principle of “subsidiarity”, which is meant to ensure that the EU makes laws only where there is a genuine need for pan-European legislation.

The EU is poised to lay down a new piece of legislation on “information and consultation” of workers. At present, all companies that straddle EU borders and have more than 1,000 employees must inform and consult their staff before announcing any substantial restructuring. This obligation is about to be extended to all EU companies with just 50 employees or more—and regardless of any cross-border structure. The British and Irish governments have protested: they say this amounts to compulsory “works councils”, entities alien to their national ways of doing things. The pair are almost certain to be outvoted by other EU members later this year.

The EU is also poised to bring in new regulations on the use of temporary workers from agencies. According to McKinsey, a management consultancy, in 1996-98 such “agency work” accounted for 11% of all new jobs created in the EU. The agencies, allowing companies to respond rapidly to changes in

demand, exemplify the economic flexibility that EU governments claim to be striving for. Among the larger EU countries, the Netherlands and Britain have the lowest unemployment—and the highest proportions, in the total labour force, of agency workers.

But Europe's trade unions have the agencies in their sights, and may well win solid backing from the European Commission. The unions say that agency workers under-cut "real jobs". Supposedly, UNICE, the European employers' federation, and its trade-union equivalent should argue this out. But their talks are going badly, and may break down on the eve of the Stockholm summit.

The commission is then likely to propose a directive on temporary workers, making large concessions to those who want to regulate the business: for example, requiring that temporary workers should be paid the same as the firm's own employees, with extra pay in lieu of pension rights. Since labour issues within the EU are decided by majority vote, those countries that object—Britain and Ireland again—can expect to lose.

Can this sort of regulatory zeal be compatible with the "spirit of Lisbon"? Maybe not, but the fact is that both the liberalising and the regulating instinct are powerful ones within the EU. Declarations about a dynamic, knowledge-based economy are habitually balanced by soothing syrup about the need for "social cohesion" and "better" jobs. In the approach to Stockholm and beyond, the proponents of economic reform will be proclaiming their success, suggesting that they are sweeping all before them. They are not.

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Spain cuts a Gordian labour knot

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AT LAST, Spain is to reform its labour law. The government waited months for employers and trade unions to agree on changes. They didn't, so now it is to impose its own version. Firing will be cheaper, hiring less risky. But the aim is not just a more flexible labour market. Some workers will get more protection. The government hopes to widen and open the market, by taking into account the big social changes since Spain escaped dictatorship.

The trouble goes back to Franco's days, but is typical of any country with paternalist labour law: too much protection of people with jobs, too little opportunity for those who want them. In 1994, the then Socialist government made a change. It did not alter the huge payments for those thrown out of work—45 days' pay, up to a maximum of 3 1/2 years' pay in all, for each year in the job—that deterred employers not just from firing but therefore from hiring. But it brought in new, short-term contracts that could be ended with no compensation at all. By now a third of Spanish employees are on contracts like this.

In 1997, after a union-employer accord, the new centre-right government of Jose Maria Aznar went further. It cut 45 days' severance pay to 33 (and the maximum total to two years' pay) for most new hirings. But it tried to limit some of the excesses of short-term hiring, and to aid the hiring of those who find jobs hardest to get—young people new to the market, people aged over 45 and the long-term unemployed.

Now the lower, 33-day limit to compensation will apply even more widely, but people on short-term contracts will be entitled to eight days' worth. Women will gain from steps to encourage part-time work and to help get them back to jobs after having children. The government will pay carefully aimed subsidies to employers' social-security costs: 25%, for two years, for newly hired women aged 16-45, and 100%, for a year, if the hiring comes within two years after childbirth; 50%, plus or minus, depending on the details, for workers of either sex aged over 55.

Neither employers nor unions, predictably, are content. Employers have long since learned to use short-term hiring to reduce their risks, but say their labour costs will still be too high. The unions say that Spain will still have far too many of its people working on short-term contracts and are talking of widespread strikes.

That threat will cut little ice. Mr Aznar was re-elected last year, with an absolute majority, mainly on the back of his success in liberalising the economy, and of the job-creation and growth that has lowered unemployment from 22% in 1996 to today's 13%. In many areas there is full male employment, and immigrants now flood in to do the jobs that Spaniards no longer want.

Yet unemployment among women is high: about 20%, double that of men. Many of those counted in the statistics are housewives who have never worked outside the home. But they are not busy having children instead: the birth-rate has fallen sharply, to far below the "population-replacement" level. Mr Aznar fears a day when an ageing native population relies on the social-security payments of immigrants. Paradoxical as it sounds, the way to get more children may be to encourage women out of the home to earn enough for the family to support more.

Youth unemployment, too, is high. Many young people get degrees in subjects that lead on to few jobs, and stay at home until they are well over 30. Over 70% of the young who do have jobs are on short-term contracts. Meanwhile, there is a shortage of skilled craftsmen in humbler activities. The constraints on firing, and therefore on long-term hiring, of young people, from the age of 16 to to 30 are being eased.

In sum, undramatic, nuts-and-bolts changes, and no promise of Utopia—just of a better and fairer way of working life.

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Russia

Land reform, kind of, maybe

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AP

So what's changed?

PRIVATE land-ownership and political freedom usually go together. But not in Russia, where it is the powers-that-be, not the people, who decide about land. It has always been that way. Before communism, there was a bit of public-spiritedness, a lot of capitalism, even the glimmerings of the rule of law. But land? Russia's rulers, whether tsars, Communists or post-Soviet bureaucrats, have never allowed their people fully to exercise the most fundamental of all property rights.

Since the collapse of Soviet power in 1991, private land-ownership has been a classic Russian muddle: it exists in theory, not in practice. The constitution allows it. A presidential decree by Boris Yeltsin in 1993 laid out some of the basic rules. But a proper land code, explaining everything from mortgage rights to rules on how land can be used, has never reached the statute book. Now President Vladimir Putin and the government want to get a move on. A land code will arrive shortly in the Duma, Russia's lower house of parliament. But formidable obstacles remain.

The main one is that strong vested interests like things the way they are. Land is a big source of power and money for the bureaucracy. Do you want to build a house? Then pay a bribe. Do you want to buy a derelict factory, and turn it into something else? Pay a lot more. Do you want to build a large dacha in a nature reserve outside Moscow? Then you probably will not need to pay anything: that sort of thing is the privilege of top officials and well-connected tycoons.

In Russia's provinces, land ranks along with the tax system as a huge source of control and patronage for local leaders and their friends. Federal government landholdings—belonging to ministries, the presidential administration, the armed forces and security services—are vast, largely secret and frequently exploited for the private convenience and profit of officials. The openness that a publicly accessible land register would bring would be most unwelcome.

Third, the agricultural lobby is nervous about upsetting the post-Soviet farming set-up. The remains of state and collective farms provide awful conditions for workers, low investment and poor yields—but rich pickings for farm bosses and their friends. Anything that would let private farmers flourish on Russia's 200m hectares (500m acres) of farmland, whether as individuals or in agribusiness, is also a threat, though in some regions like Saratov and Tatarstan, local governors have gone ahead and privatised land, with modestly encouraging results. Private farms are already more productive.

This debate is dressed up in fancy language. Agrarian, nationalist and left-wing politicians talk of land reform in terms of the rape and pillage of Russian tradition. "It's like selling your own mother," says one. Collectivism, they say, is the natural state of affairs in the countryside. But there are serious worries too. Unlike industry, much of which has been grabbed by a mix of Soviet-era managers and new spivs, most land is at least still nominally in the collective hands of ordinary Russians. Alexander Solzhenitsyn, a veteran dissident, recently said that a free market in farmland would benefit "the greedy hands of robbers who have stolen billions from Russia". He and others fear that, if big business gets its hands on agriculture, a new class of landless peasants will emerge. Russians already hear the word *latifundiya* and do not like the sound of it.

Yet that debate is so far an artificial one. Even if farmland were fully privatised, and could be freely bought and sold, demand for it is so low, supply so large, and prices so low, that there would be little early change. Private farmers, about 260,000 of them, work about a tenth of the total. But their problems are many, and their number is falling.

The new code deals only with urban land, although it does not have the outright ban on sales of farmland that the rural lobby wants. Urban land reform has more support. Homeowners and businessmen want secure title to the land on which their property stands. But there are stumbling-blocks. One is a cadastral survey, to give a clear definition of each plot of land. This is well advanced in some cities, far less so in others. Sergei Say, the civil servant who heads the federal cadastre service, reckons it will be five years before the land register is complete and publicly accessible.

Another difficulty is that of getting decisions on land use, a notorious source of corruption even in countries with far more honest public services than Russia's. Even if the new law lays down the rules for changing a plot, say, from industrial to residential use, local bureaucrats would find it hard to shake off old interfering habits.

Clear new rules about land, even if limited to some categories and hampered by bureaucrats, would be an encouraging symbolic step. But to make a real difference, they would need a lot of political oomph behind them. That is not yet in prospect. Mr Putin's current plan seems to be to allow governors to interpret the new land code flexibly, region by region. That sounds bad for reform.

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Gordon Brown's balancing act

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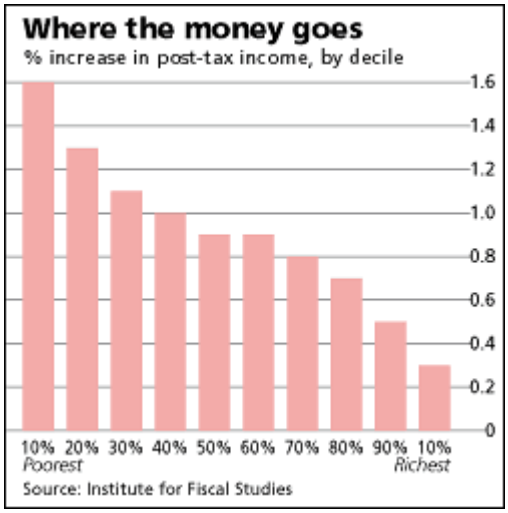
The chancellor walked a fine line between electioneering and prudence in his fifth budget. He just managed to retain his balance

Get article background

IN HIS pre-election budget, Gordon Brown's objective was self-evident: to ensure victory for Labour at the polls. But achieving this was not so straightforward. The chancellor of the exchequer needed to please key groups of voters without letting slip his and Labour's hard-won reputation as a trusted steward of the nation's finances. Too big a give-away and Mr Brown could alienate both business and an electorate grown cynical with electioneering budgets. While tilting a little far towards crowd-pleasing, the chancellor just managed to keep his balance.

Fittingly for someone recently married, his budget measures were a mixture of something old and something new—if not something borrowed, something blue. Despite its well-trailed contents, Mr Brown still had some surprises ready. The biggest was yet higher public-spending allocations: a total of £650m ($950m) more a year on hospitals and schools over the next three years. Mr Brown also unveiled a bonus for newborn babies on top of the children's tax credit. The bonus will be worth up to £10 a week for half a million families when it starts in 2002-03. In addition to these new measures, the chancellor confirmed "old" ones that he had already outlined in the pre-budget report in November, subject to consultation and so not yet included in the Treasury's overall forecasts for the public finances. As expected, motorists will pay 2p per litre less in duty for ultra-low sulphur (ULS) petrol and 3p less for ULS diesel.

Mr Brown designed his budget to mobilise two principal groups of voters. The first lot were Labour's "heartland" voters—traditional but disillusioned Labour supporters across the country that party strategists fear may not turn out to vote in crucial marginal constituencies. Mr Brown reinforced the government's credentials with this group through a healthy £5 a week increase in the working families' tax credit and higher payments to families on income support. He re-emphasised the impact of measures already taken, such as the concessions to pensioners made last November. He said that 7.5m pensioners will now pay no tax at all or tax at just 10%. According to the Institute for Fiscal Studies, the households that will benefit most from the budget are the poorest ones (see chart)—in line with the effects of the chancellor's first four budgets.



But Mr Brown also had to think of Middle England. The chancellor knew it was essential to look after Worcester Woman and Essex Man, those archetypal voters that helped Labour to win the election in 1997. Labour has to retain the

support of these lower middle- and skilled working-class voters if it is to win another thumping majority, explains Roger Mortimore of MORI, a polling organisation. With his rhetorical appeal to rewarding “hard-working families,” Gordon Brown duly sought to woo these voters with the extra spending on education and health. In addition, they will benefit from the £300 widening of the lower-rate 10% income tax band.

Middle-income families will also gain from the children’s tax credit, most of whose impact does not show up in the chart since it was not a new budget measure. The chancellor did announce, however, that the children’s tax credit would be more generous, bringing down income tax for 5m families by up to £10 rather than £8.50 a week.

Prudence forsaken?

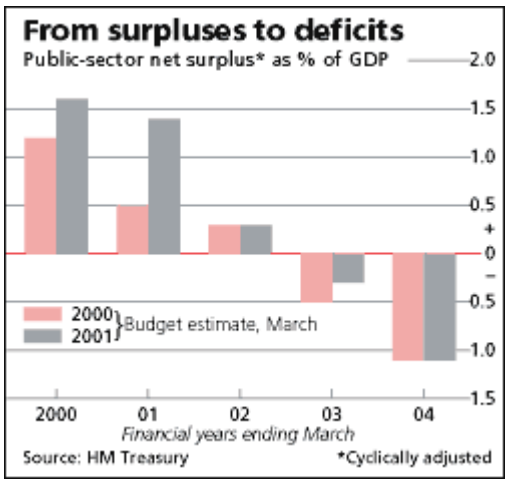
Shortly before the budget, the International Monetary Fund warned Mr Brown not to make “significant new spending commitments or tax cuts”. Altogether the cost of the measures the chancellor announced, including the decision to carry forward £1 billion of underspending by government departments this year into 2001-02, came to £5.3 billion or 0.5% of GDP. That sounds significant, but it includes the £2 billion cost of "old” concessions flagged in November’s pre-budget report (but not included in the projections). Whether a package of new measures costing £3.3 billion is “significant” can be debated. What is clear is that the total relaxation in policy since November is substantial, since the pre-budget report also included a £2.6 billion give-away for 2001-02.

However, Mr Brown argued that he had chosen “the prudent course for Britain”. He said that the budget conformed to his two fiscal rules: borrowing only to invest and keeping debt at a sustainable level. Looking forward, the government will run big surpluses on the current budget. Net public debt will fall in 2001-02 to 30% of GDP and stay around that level for the next few years.

The Treasury argues that the budget should be assessed by comparing the fiscal stance in 2001-02 and beyond with what was planned in last year’s budget. By this yardstick, Mr Brown is now projecting a slightly tighter fiscal stance for the coming financial year—a surplus of £6 billion rather than the £5 billion forecast a year ago. The fiscal stance is also slightly tighter for 2002-03 and subsequent years. This reflects the far bigger surplus of £16.4 billion the government now expects to run this year—over £10 billion more than it forecast last March. Income-tax revenues have overshot by £6 billion while spending on social-security benefits and debt interest has undershot by £2 billion. The Treasury now expects the structural improvement in income-tax receipts in 2000-01 to continue, although this will be partially offset by the cost of the more generous lower-rate income-tax band and children’s tax credit. It has also pencilled in even bigger savings of £6 billion in debt interest and social security next year before any offsetting effects from budgetary measures.

But the government’s two fiscal rules are useful rules of thumb rather than master guides. The golden rule of borrowing only to invest, drawn up when deficits appeared endemic, offers little help when you are running big surpluses. And judging budgets by the yardstick of earlier forecasts says more about the fallibility of those predictions than it does about the thrust of fiscal policy.

It is certainly true that the budgetary stance has been much tighter this year than the Treasury expected, which in turn leaves the fiscal stance next year slightly tighter than predicted last March. But what matters now is the change that will occur between this year and next. The Treasury forecasts that the public-sector surplus (adjusted for the economic cycle) will fall from 1.4% of GDP in 2000-01 to 0.3% in 2001-02 (see chart). That is a big fiscal relaxation by any standard.



In effect, the fiscal easing planned for the financial year now ending has been deferred to the year starting in April. But there is undeniably a big difference from the position last year, when the IMF described the budget as “regrettably pro-cyclical”. The British economy was then gathering speed, whereas it is now threatened by the American slowdown. Arguably this budget could be described as fortuitously anti-cyclical. In that, as in so much of his time at the Treasury, the chancellor has been lucky.

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Budget in brief

Mar 8th 2001
From The Economist print edition

For families

Get article background

•Children's tax credit to be increased from £442 to £520 a year. Higher children's tax credit of £1,040 for the first year of a child's life, from April 2002

•Statutory maternity pay to increase from £60 a week to £100 over two years, and the period to lengthen from 18 to 26 weeks, from April 2003

•Two weeks' paternity leave at the same rate from 2003

•Working families' tax credit (WFTC) to rise by £5 a week

•Child-care tax credit limits within the WFTC to rise from £100 to £135 a week for one child and from £150 to £200 for two or more

For everybody

•Band for 10p tax rate to widen from the first £1,580 of taxable income to £1,880

For hospitals and schools

•£650m of extra annual spending over the next three years

For business

•Research and development tax credit to be extended to larger companies, subject to consultation

•Long-term capital gains tax for employees with shares in companies to fall from 40% to 10%

•Value of employees' share options qualifying for tax relief under the Enterprise Management Incentives to double to £3m per company

•VAT regime for businesses with a turnover of up to £600,000 to be simplified

•VAT registration threshold to rise to £54,000-a-year turnover

For poor areas

•Stamp duty to be abolished in the poorest bits of Britain

•VAT on residential-property conversions to fall to 5%

•Empty flats over shops to attract 100% first year capital allowances

For culture

•VAT on repairs to listed church buildings to fall to 5%

•National museums and galleries to receive VAT refunds when they allow free admission

•Film-industry tax relief to be extended to 2005

For the unemployed

•£200m for extra mentoring and training for hard-to-employ over-25s

•A three-year £40m programme for training for ex-drug addicts

•A £100m scheme to get more lone parents into work

For drivers

•£55 reduction in car licence fees to be extended to all cars with engines of up to 1,549cc

•Duty on ultra-low sulphur petrol to be cut by 2p a litre; on ultra-low sulphur diesel by 3p a litre

•Duty on road fuel gases (alternative fuels) to be cut by the equivalent of 3p a litre and not increased in real terms until 2004

For drinkers and smokers

•Duties on spirits, wine and beer to be frozen

•Cigarette duty on a packet of 20 to rise by 6p, in line with inflation but not an increase in real-terms

For gamblers

•Betting duty abolished

For the dead

•Inheritance-tax threshold to rise to £242,000

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The Budget and business

Only relate

Mar 8th 2001
From The Economist print edition

Mr Brown sought to improve relations with employers, but they won't like his new measures for working parents

Get article background

EMPLOYERS' votes do not count for much, but their views do. Labour benefited in the 1997 election from its great love-in with business. But the affair has turned sour in the past year. Employer organisations have complained vehemently about the rise in corporate taxation and the heavy cost of new regulations. So one of Gordon Brown's goals in this budget was to improve relations with business.

The corporate sector has undoubtedly borne the brunt of Mr Brown's tax increases. According to the Confederation of British Industry (CBI), companies have paid an extra £5 billion a year in taxation since 1997. In previous budgets, the chancellor has certainly made some eye-catching concessions to firms. Corporation tax rates have been lowered from 33% to 30%, with a 20% rate for small businesses and a 10% starting rate for very small firms. Small and medium-sized businesses have also been particularly favoured with higher first-year tax allowances for capital spending and a tax credit for research and development (R&D). However, these concessions have been swamped by the abolition of dividend tax credits for pension funds—the original "stealth tax"—and the introduction of a new system for paying corporation tax, which has had the effect of bringing forward £8 billion of revenues over a four-year period starting in 1999.

Stung by criticism from business after last year's budget, Mr Brown tried harder to please in this one. He delivered little but promised quite a lot, especially to manufacturers and small firms. His most important pledge was a plan to provide an R&D tax credit for bigger companies, which he described as "the next tax incentive to back manufacturing and innovation".

At present, only firms with an annual turnover of up to £25m that spend at least £25,000 a year on R&D qualify for a tax credit. However, large companies account for 85% of total R&D. Furthermore, international comparisons show that British business spends much less on R&D than business in other comparable countries like Germany and America. With the notable exception of the pharmaceuticals sector, the shortfall is concentrated in manufacturing, where Britain trails behind.

To remedy these deficiencies, the chancellor is proposing a tax credit that will help larger companies if they increase their R&D spending, an approach already in use in countries such as Japan and America. One potential stumbling-block to the proposal, on which the government will now hold consultations, is that the European Commission will have to agree that it does not constitute an unfair state aid. However, Mr Brown is confident that he can persuade fellow European finance ministers that support for R&D should be encouraged in order to foster innovation and higher productivity throughout the EU.

The proposal for an R&D tax credit has gone down well with business groups, understandably since they have been lobbying hard for such assistance. They also welcomed signs that the chancellor was now taking complaints about the burden of regulations seriously. The chancellor's main initiative against red tape was a new regime to simplify VAT for small businesses, which he said would help up to half a million companies. He also announced a proposal to simplify corporation tax for small businesses by making their annual accounts the basis for calculating tax, saying that this would cut still more red tape. Digby Jones, director-general of the CBI, said that "the changes in VAT for smaller firms are exactly what we've been asking for."

But businessmen still have their doubts about Mr Brown. "His great tendency is to tinker," says John Whiting, a tax partner at PricewaterhouseCoopers, an accountancy firm. And, while reducing the burden of some regulations, the budget also announced higher rates of statutory maternity pay, to be available for a longer period from 2003. Working fathers will also then have the right to two weeks of paid paternity leave. Such measures, however desirable for families with new babies, can cause real problems

for small firms. Furthermore, the budget conspicuously failed to meet many other demands made by employer groups. For example, the stamp duty for commercial purchases of property remained unchanged and the chancellor did nothing to reduce stamp duty on share transactions. Labour's relationship with business is likely to remain troubled.

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Terrorism

Real trouble

Mar 8th 2001 | BELFAST
From The Economist print edition

IN 1998, a bomb planted by the Real IRA in Omagh, a small town in Northern Ireland, killed 29 people. So great was the revulsion against the organisation then that many thought it would not survive. Sadly, it seems to have done so. The bomb planted in a London taxi outside the BBC's headquarters on March 4th was the fourth attack in the capital since last summer, though the first to cause considerable damage. The previous attack was a rocket last September aimed at the headquarters of MI6.

Reuters

A visit from the Real IRA

The Real IRA has chosen high-profile targets in London, and the mathematics of terrorist violence—one chance success can cause huge damage—make it impossible to be dismissive, even about a group with little support on the streets and few experienced bombers among its members. Terrorism needs only a small dash of luck to be successful. Early this year, a partially detonated bomb at an army barracks in County Londonderry would have killed many sleeping soldiers if it had exploded as planned.

The Real IRA was born in 1997, after the IRA restored its ceasefire so that Sinn Fein could be part of the negotiations on power-sharing in government. Five veterans of the IRA's managing executive, all of them from south of the border, walked out. One was the quarter-master in charge of arms dumps. Some weapons went missing.

The seniority of the defectors was damaging, but the dissidents are thought to represent no more than a fraction of the 2-3% of the population north of the border who opposed the 1998 referendums north and south on the peace agreement. An attempt to establish a political wing, the 32-county Sovereignty Movement, fizzled out. Many Real IRA operations, on both sides of the Irish border, have been scuppered by police. That suggests that the group is thoroughly infiltrated—but not thoroughly destroyed.

There have been several Real IRA bombings in Northern Ireland this year, and arrests afterwards show that the group has attracted many inexperienced youths, but also a number of discontented IRA bomb-makers, some of whom have clearly looted arms dumps for guns. They may also have picked up some Semtex plastic explosive, the IRA's favourite tool. Finds suggest that the dissidents have also established new sources of arms, for example in Croatia. Some people in the security forces believe they have now absorbed an older republican splinter group, the Continuity IRA.

The Real IRA is led from the Republic of Ireland, as the IRA was, with support in northern border districts like South Armagh and Fermanagh. But in October last year the mainstream IRA shot and killed a Real IRA organiser, Joseph O'Connor, in their own stronghold of West Belfast. His murder lent support to the growing, and worrying, belief that the dissidents had begun to make headway outside border districts.

Republicans in the north are scathing about the "Brits Out" mentality of the Real IRA stalwarts in the deep south. The dissidents in turn mock people such as Martin McGuinness, a former IRA commander, who is now minister for education. They accuse him of helping the unionists to administer British rule. Among some, that has a certain force. Terrorism is an easy business, in many ways, compared to the difficulties of trying to make new government work, in partnership with the traditional enemy.

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Bagehot

Hague's silly sally

Mar 8th 2001
From The Economist print edition

LIKE Conservatism itself, "compassionate conservatism" is a difficult idea to pin down. But whatever it means, Bagehot feels a growing compassion for the Conservative leader, William Hague. The poor man seems incapable of getting it right. Last weekend he gave what was supposed to be a final, rousing, pre-election speech to the depleted forces of Conservatism, who had assembled in Harrogate for their party's spring conference. Most of those present found the speech quite funny. Mr Hague invited his audience to visit the "foreign land" that Britain was in danger of becoming after another term of Tony Blair. The horrors he enumerated were the Royal Mint melting pound coins to make way for the euro, the chancellor returning from Brussels with orders to raise taxes, the jail doors opening to release criminals early, fuel taxes rising, hospitals cancelling operations, the Dome still for sale, Peter Mandelson back in the cabinet for a fourth time, the Liberal Democrats still on the edge of their seats convinced that Mr Blair's promised referendum on voting reform was just around the corner. He also, in a separate bit of his speech, promised that a Conservative government would sort out Britain's "asylum crisis". It would assess claims within weeks rather than years, and immediately deport asylum-seekers whose claims were unfounded.

This speech pleased the *Daily Mail* well enough. But many other commentators coupled the "foreign land" bit of the speech to the asylum bit and then to the Eurosceptical bit and so detected a single, odious, train of Hagueite thought. The Conservative leader, they concluded, was guilty of "base nationalism" (the *Independent*), "playing the race card from the bottom of the deck" (the *Times*) and displaying hostility to the EU of a "breadth he's never shown before" (the *Guardian*). As after earlier controversial speeches on policing or asylum, Mr Hague had to fend off accusations that he was a racist. But he could not claim this time to be surprised. Part of his speech —"talk about crime and they call you reactionary; talk about asylum and they call you racist..."—was a defiant peroration against political correctness. In other words, he understood the reaction he would provoke, and still judged the provocation to be worthwhile.

That was a mistake. No liberal-minded person would deny that Mr Hague is entitled to explain his policy on asylum. But he chose the wrong occasion. The last speech before his last party conference before the election was where Mr Hague was expected to set out his biggest ideas: his indictment of Blairism and his vision of what now made Conservatism distinctive and alluring. Neither half of this job was going to be easy. How to indict a Labour government that has hardly put a foot wrong on the economy? How to make the old Conservatives look alluring when New Labour has filched so many Conservative ideas?

Before going to Harrogate, Mr Hague had seen one arrow after another bounce harmlessly off Tony Blair's shield. The Tories had hoped the Hinduja passport affair would make the government look sleazy. And so it did: more than 70% of respondents told MORI at the end of January that Peter Mandelson's resignation had damaged the government's reputation. But the same poll found that this had made no difference to people's voting intentions. The Tories hoped that the government would fail to transform public services. It did fail: Mr Blair himself has admitted to raising expectations too high. But the Tories have not yet profited from their expensive campaign on the theme of "you've paid the taxes, so where are the teachers/doctors/nurses?" A MORI poll in January found that voters were disappointed with many aspects of Labour's record on health and schooling. But the same poll found that most voters expected public services to stay the same (45%) or get worse (32%) under the Tories. Astonishingly, neither Mr Hague nor Labour—with its scaremongering posters about £16 billion ($23 billion) of Tory spending "cuts"—have persuaded voters that the Conservatives would even reduce taxes. According to MORI, most people believe that taxes would either remain at about the same level (43%) or rise (35%) under the

Tories.

So maybe it was desperation that drove Mr Hague to make so much in Harrogate of the Tories' promise to "give you back your country". This would consist mainly of fixing a constitution vandalised by Mr Blair, opposing the sovereignty-devouring encroachments of the EU and repatriating some powers already ceded to Brussels. It is a policy that Mr Hague's critics, in his own party and in others, disparage as xenophobic, but that all the polling evidence shows to be popular. A large majority of voters opposes Mr Blair's plan to join the euro. MORI reported last June that more than 60% of British people thought joining would mean giving up their "national identity". But suspicion of the EU goes much deeper even than that. A few polls have shown small majorities in favour of leaving the EU altogether. A December poll by ICM, administered in seven EU countries, showed that Britons alone opposed the idea of electing the EU president directly. They are less willing than any other EU citizens to call themselves "European" and much less trusting of the Union's institutions. Let liberal commentators denounce Mr Hague as a Little Englander: his sceptical line on the EU causes tension in the party but endows it with at least one arrow capable of penetrating Mr Blair's armour.

Which, paradoxically, is why Mr Hague's little sally on asylum-seekers was a mistake. British Euroscepticism stems from many different motives: technical worries about monetary union, concern about sovereignty, a belief in the resilience of Britain's own political institutions. But at some point along this spectrum, the respectable motives shade into less respectable ones, and finally into the petty loathing of foreigners that Mr Hague is accused of pandering to in Harrogate. By making it easier for enemies to impugn his motives, he may have blunted his sharpest weapon.

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Fat-cat lawyers

Silks' purses

Mar 8th 2001
From The Economist print edition

The Labour government may be ready to challenge the restrictive practices of the professions

"LET'S kill all the lawyers," sounded to Shakespeare like a fine rallying-cry. The government, with an election approaching, agrees, and has decided to have a pop at the fat cats in the professions.

This week, the Office of Fair Trading (OFT) published the results of its nine-month inquiry into the restrictive practices of professionals. Its investigation into the way solicitors, barristers, accountants and architects do business turned up a series of uncompetitive practices from restrictions on entry, supply and advertising, to rigging of fees. This is no great surprise; indeed, anti-competitive behaviour is officially sanctioned, since the professions are currently excluded from competition laws.

Taking the lawyers as an example of the professions as a whole, one of the main areas of concern is the huge discrepancy in fees for doing humdrum jobs. A Consumers' Association survey found that the cost of conveyancing a £75,000 ($110,000) freehold house (putting a legal stamp on the sale, in effect) ranged between £117 and £750. Such huge variations do not suggest the presence of either strong competition or price transparency.

The secretive manner in which Queen's Counsels (QCs) are appointed from the ranks of senior barristers also attracts criticism. The report questions whether it is proper for the government to give selected lawyers "a title that manifestly enhances their earning power and competitive position". And it questions the point of the title: since lay clients have access to barristers not directly, but through solicitors, the claim that it serves as a useful kite-mark of quality is hard to sustain.

Astonishingly, the OFT has nothing to say about barristers' fees. It hived off the job of research to the Law and Economics Consulting Group which says that it was unable to find any reliable data on fees, profits or earnings. It does not appear to have looked very far. A recent survey of barristers' earnings by Chambers and Partners, a firm of legal publishers, found that 26 specialists in commercial work earn more than £1m a year apiece. Annual earnings of top tax QCs range from £300,000 to £2m. Criminal QCs have to content themselves with annual earnings of £150,000 to £550,000.

The report found no evidence of collusion among barristers over fees. Not surprising, really. The only people who would know much about that are the clerks of chambers, who negotiate fees on behalf of barristers, and do very nicely, thank you. In the busiest commercial sets, they earn more than £250,000 a year. They are bound to secrecy by a code of *omerta* that evidently frustrated the OFT.

Solicitors rarely haggle over fees because barristers' bills are small in relation to overall legal fees. It is the solicitors, say the barristers, who make the real money. According to a prominent libel QC, it is solicitors who do the real "pillaging" of clients.

One of the factors pushing up legal bills is the willingness of clients to pay for the best. In a dispute worth several hundred million pounds, that may well make sense. But most legal work does not demand star presence; and there are signs that the worm may be turning. A recent survey by a magazine, *Legal Director*, of 100 big companies found increasing levels of dissatisfaction with the size of their legal bills.

The government may be ready to weigh in, too. Of course, lawyers have long years of experience in seeing off threats to their wallets, and they have powerful friends—not least the lord chancellor, Lord Irvine. Moreover, the report's conclusion that they should have a year's grace to change will give them ample opportunity to find ways of sustaining their comfortable life-styles. But if the government decides to amend the 1998 Competition Act to include the professions, they will eventually have to reform. That is the test of the government's will.

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The law

In double jeopardy

Mar 8th 2001
From The Economist print edition

LAST week the Law Commission, the independent body that advises Parliament on changes to the law, made a proposal which could remove an arcane obstacle to the pursuit of justice, or dangerously augment the power of the state, depending on your point of view. It recommended that the Court of Appeal should be allowed to quash acquittals in murder cases, where there is compelling new evidence and a retrial would be in the interests of justice.

In other words, an exception should be made to the "double-jeopardy" rule, which protects people from being charged with an offence if they have already been acquitted of it. (The rule can currently be disregarded only if the original trial was nobbled.) The recommended change would be retrospective, so that around 35 cases in which the defendant was acquitted, but police still think he was guilty, could be revisited.

The arguments for amending the law seem convincing. The double-jeopardy rule deprives some victims of justice. It allows brazen murderers to pen "kill and tell" autobiographies, undermining public confidence in the criminal justice system. Fresh evidence that belatedly becomes available, for example through new scientific techniques such as DNA testing, should be considered. Convictions can be quashed, so why not acquittals?

Yet the commissioners seem almost to have accepted the case for preserving the rule without exception. Their original suggestion was for a more radical change—in cases where a sentence of at least three years' imprisonment was likely if the defendant were found guilty. Last year, a committee of members of Parliament suggested that the double-jeopardy rule should be changed only in cases punishable by life imprisonment. The commission now says that the rule is such an important statement of the limitations on the state's powers, and of the individual's right not to be harassed, that murder is the only case in which it should be disregarded.

But there are practical reasons to worry about even such a limited reform. In deciding whether to grant a retrial, the court would have to consider whether it would be fair, and reporting restrictions would be imposed. But there is still a risk that in some trials the presumption of innocence will be undermined. The police may be less rigorous in their initial investigations if they know they may get a second chance. Most miscarriages of justice arise when police find untoward ways to vindicate their hunches: retrials would give them another chance to do so.

Libertarians, of course, always worry about the thick end of any wedge. In this instance, they ought to. The grounds for making murder a unique exception to the double-jeopardy principle are shaky. The commission has also recommended that new evidence should make only one retrial possible. But once the principle has been compromised, it seems likely that the rule will be diluted further in the future.

But perhaps the main cause for alarm is that, if adopted, the proposal would add to the ongoing, incremental subversion of the rights suspects have traditionally enjoyed. Last week Jack Straw, the home secretary, spelled out his plans to allow the seizure of assets belonging to people suspected, but not actually convicted, of a criminal offence. He is determined to abolish the right of some defendants to opt for a trial by jury. The valuable (if costly) principle that respecting innocence is more important than punishing guilt is being gradually eroded.

Some liberal commentators have welcomed the Law Commission's ideas, because they derive ultimately from the emotive case of Stephen Lawrence, a black teenager murdered in 1993. Three white youths

were acquitted of the crime following a private prosecution; a subsequent inquiry suggested that a change in the double-jeopardy rule should be considered.

But the Lawrence case provides little grounds for changing the law. Even if new evidence were forthcoming, any judge would be unlikely to think that the acquitted youths could receive a fair trial: Sir William Macpherson, who conducted the Lawrence inquiry, himself says that the “prejudice against them is enormous”. And the basic problem in the Lawrence case was sloppy policing. Changing the law in a way that might encourage more of the same would be a bad way to respond.

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Road rage

Mar 8th 2001
From The Economist print edition

ALONG with Big Ben, red double-decker buses, and the pigeons that lived in Trafalgar Square until Ken Livingstone, the mayor of London, decided to banish them, the black cab is one of the most recognisable symbols of the capital. But London's cabbies are worried that a perverse regulation may drive them off the streets. The wrangle involves allegations of monopoly dealing, pits the claims of safety against environmentalism, and highlights the perils of devolution. The regulation is not the brainchild of some crazed European bureaucrat, but an ancient domestic one.

London's first recorded cab journey took place in 1588. The requirement for cabbies to know the capital like the back of their hands—or, to give the rite its proper title, to "do the knowledge"—derives from the Great Exhibition of 1851, when there were widespread complaints about ignorant drivers. The first cab with an internal combustion engine hit London's streets in 1903. Tom Scullion, of the Society of Professional Licensed Taxi Drivers, says that the now-controversial regulation derives from that vehicle—and not, as other cognoscenti claim, from the exigencies of manoeuvring serenely outside the Savoy hotel.

The regulations issued by the Public Carriage Office (established in 1850, but now under the auspices of the mayor's Transport for London) state that cabs must be able to perform a U-turn in a space not more than 8.535m wide. Transport for London says that the rule ensures the necessary manoeuvrability, and guarantees that passengers can hail a cab from the wrong side of the road.

But critics say that other towns have modernised their regulations, and that the rule should go the same way as the requirement for Hackney carriages to carry a bale of hay. Gerry Facenna, of Cab Direct, a taxi-manufacturing company, points out that there are numerous London streets in which U-turns are proscribed, not to mention a farrago of one-way roads in which they are impossible.

Mr Facenna is aggrieved because his taxis have, like others, fallen foul of the U-turn test. Of the two companies whose vehicles pass it, one has recently gone into receivership. Mr Facenna says that his taxi, while less nifty at U-turns, produces up to half as many harmful emissions and costs £7,000 less than the only one still in production that meets the U-turn standard. The cabbies say they have become victims of a monopoly, just as their business is threatened by the licensing of minicabs.

Solicitations have been made to Mr Livingstone. London's cabbies must hope that the mayor has more affection for the black cab than he has shown to pigeons.

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The price of civic pride

Mar 8th 2001 | GLASGOW
From The Economist print edition

THOSE in charge of Britain's town halls have only to hear the word culture, it seems, and they reach for application forms. Being the European City of Culture, an accolade bestowed annually by the European Commission, brings in not one penny of subsidy; yet as many as 50 cities and towns from Inverness to Brighton are thinking about bidding to be the next British holder of the title in 2008.

The prize, apart from being an excuse for councillors to puff up their chests, is civic prestige: transforming the way people inside and outside a city think of the place. The model for this is Glasgow, which used its year in the cultural spotlight in 1990 to get rid of its run-down heavy industrial image and reinvent itself as a centre of art and fashion.

People in Liverpool, Cardiff and Bradford who want to give their city a makeover know by heart the economic benefits it brought to Glasgow. "Its tourist numbers increased by 81% in one year and its conference business increased by 45%," says Neil Rami, director of the joint bid by Newcastle and neighbouring Gateshead. Cultural activity boomed too. Long-disused tram sheds and market buildings were turned into theatre and concert venues, cafes and restaurants sprouted, and the city council spent heavily on such things as a new gallery of modern art.

But this new image comes at a price, which Glasgow is now struggling to pay. The council says it needs £2m ($2.9m) from the devolved Scottish government for its galleries and museums. The McLellan Galleries, converted into an international-standard temporary exhibition space for £3m in 1990, will have to close soon to save money.

Mark O'Neill, head of the city's museums and galleries, says that despite spending £6.3m a year on its museums and galleries—more per head than any other Scottish local authority—Glasgow's council cannot maintain its collection to international standards. Scottish Opera, based in Glasgow, gets about £6m a year in subsidy. Despite getting £2m to stave off bankruptcy in 2000, it is now asking the Scottish government for another £1m handout.

Since 1990, all sorts of arts ventures have sprung up. Giles Havergal, director of the long-established Glasgow Citizens Theatre, applauds the fact that there are more theatres now. But, he says, "I think there are slightly more seats than there are bums for them."

Glasgow's arts impresarios have a particular problem. A reorganisation of local government in 1996 abolished Strathclyde Regional Council, which handed out lots of cash to the arts. Glasgow Council could not make up the shortfall. Mr Havergal had to slash the drama output by the Citizens, an innovative theatre group.

But that apart, Glasgow's lesson for other would-be cities of culture is that, whereas the honour may bring in lots of tourists, cultural organisations are incapable of making money out of them. And, if being a city of culture means there is a lot more culture about, a lot more subsidy will be needed to keep it going.

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A war over drugs and patents

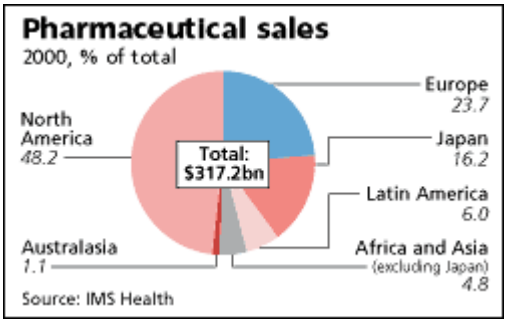
Mar 8th 2001 | JOHANNESBURG
From The Economist print edition

Although the legal battle in South Africa has been postponed, the war over providing cheap drugs for the poor goes on

WHEN it comes to disease, rich countries are quick to share their wealth. For centuries, tuberculosis, measles and other ailments made inroads into much of the poor world, courtesy of the West. But they are less ready to share their pharmaceutical solutions to these and other ills.

AP

Drug making is an expensive business, and pharmaceutical companies have largely concentrated their attentions on markets in industrialised countries (see chart below). This is where they can recoup their hefty research, development and marketing costs. While millions of people in poor countries share an equal or greater need for these medicines, they lack the money to buy them at western prices. How to increase poor people's access to costly, life-saving drugs is one of the most vexing questions facing governments, drug companies and medical charities.



South Africa believes that it has come up with a solution. Four years ago, the government drafted laws that would give it more flexibility in procuring medicines either from homegrown sources or from cheaper foreign exporters, and has been working on the details ever since. In response, 39 pharmaceutical firms are suing the government because, they claim, the changes would contravene South Africa's constitutional protection of their patent rights. The case, which began on March 5th, has been adjourned until April 18th. But the war of words outside the court continues.

The government's argument is that hundreds of thousands of South Africans die every year from diseases, such as AIDS, tuberculosis and malaria that could be cured, prevented or alleviated with drugs. Many of these are unaffordable, because of patents, which allow the inventors a monopoly of 20 years from the date the patent is filed (ie, roughly ten years from the time the drug reaches the market). In order to save lives, the government says it should sometimes be allowed to infringe these patents.

According to Patricia Lambert, legal adviser to the health minister, the government has proposed several ways of doing this. One is to allow "parallel imports". This means that if the state can find cheaper supplies of a patented drug abroad than it can in South Africa, it may import them from a country with weaker patent laws without the patent-holder's permission. An alternative is to allow "compulsory licensing". That means that, if the government deems a drug too costly, it can license a local generic manufacturer to make it more cheaply or buy a generic version from another country.

The drug companies argue that South Africa's proposed compulsory-licensing law gives the health minister too much discretion. She will, they say, be able to grab their ideas without proper legal authority, and without adequate compensation.

South Africa is unusual: it is really a small rich country within a large poor one. Under apartheid, the government was mainly concerned about the rich enclave, so the country adopted western patent laws. Western pharmaceutical firms are anxious at the prospect of generic copies entering South Africa; they fear that these will leak out of the public health service and into the more lucrative private market in South Africa, or as far away as Europe or America.

Last year, five companies offered certain African countries, including South Africa, discounts of 70-90%

on several drugs to treat HIV infection. Few governments took up the offers. A price war is now breaking out as drug companies fall over themselves to fight the threat of generic products and regain a toehold on the moral high ground. Merck, an American company, said this week that it was cutting the price in Africa of two of its AIDS-fighting drugs to a tenth of what the drug costs in America. Other companies plan to follow suit.

But the South African government argues that the drugs are too expensive, even at bargain-basement prices. Although a couple of Indian companies have offered to sell generic or copycat versions of some of the most expensive anti-HIV drugs at prices that are a fraction of those on the private market—and have been challenged by GlaxoSmithKline for doing this in Ghana—the South African government claims that even that is too much for the public sector to afford, and that other means must be found.

The South African case has provoked hysterical claims on both sides, with drug companies accusing the government of patent piracy and AIDS activists accusing the drug firms of genocide. The truth, unsurprisingly, lies in the middle or elsewhere. Without patents, the AIDS drugs would not even exist. And although patents are clearly an obstacle to the distribution of the drugs, they are not the only one. Many poor countries have no patent laws at all, but still cannot afford even the cheapest generic drugs. Most African AIDS sufferers need adequate food and clean water before they need drugs.

South Africa has at least 4m HIV-positive citizens (out of a population of 43m), almost none of whom can afford anti-AIDS drugs. The government admits that, even if AIDS drugs were far cheaper, it would still be hard to get poor, illiterate patients to take the correct doses of dozens of pills at the correct time and with regular meals, as is required. In many rural areas, it would be impossible. Even in cities, health services are erratic—about 50% of drug stocks are reckoned to be stolen from public hospitals and clinics. It would, however, be feasible to cut the transmission of AIDS from mother to child during childbirth by about 50% if the government would make generally available a simple, and cheap, treatment. It is reluctant to do so, though, partly because of its deep-seated hostility to the drug companies.

Harvey Bale, the head of the International Federation of Pharmaceutical Manufacturers' Associations, worries about the precedent that a defeat for the drug companies in a South African court would set. He fears that other poor countries, which may also have profitable markets among their rich minority, will follow the lead and alter their patent legislation. Kenya has already announced imminent changes to its laws to allow the import of cheap generic drugs.

The European Commission has recently endorsed the idea of discounted prices for poor countries, and drug firms are fearful of how politicians in America will respond. The companies are all too aware that fighting this sensitive battle does nothing for their image as a caring, sharing industry.

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Mugabe's courtesy visit to Europe

Mar 8th 2001 | BRUSSELS
From The Economist print edition

ZIMBABWE'S despotic president, Robert Mugabe, paid a lightning visit to Paris and Brussels this week. His busy schedule included meetings with Guy Verhofstadt, the Belgian prime minister, Poul Nielson, the European Union's commissioner for development aid, and Jacques Chirac, the French president. In between times in Brussels, his bodyguards punched a militant British protester.

EPA

Open door for a despot

Mr Mugabe's visit was hailed as a propaganda coup back home. His meeting with Mr Chirac, he said, was excellent. But it may all ultimately backfire. Some members of the European Parliament were so disquieted by his reception that they are promoting a motion calling for the EU to cut off development aid to Zimbabwe.

According to Geoffrey Van Orden, a British conservative who is sponsoring the motion, the EU is giving Zimbabwe development aid worth about 129m euros ($120m)—a considerable sum for near-bankrupt Zimbabwe. Mr Van Orden and his colleagues in the European People's Party, a centre-right grouping, are confident that Parliament will support their motion on March 15th. Although it will not have any binding force, it will certainly make life harder for those Europeans who want to pursue a strategy of "constructive engagement" with Zimbabwe.

The European leaders who met Mr Mugabe have offered a variety of reasons for doing so. The French mutter platitudes about the importance of dialogue. The Belgians see Mr Mugabe as crucial to finding a solution to the civil war in Congo, a former colonial territory of theirs. But the relaxed attitude to high-level meetings with Zimbabwe presents a contrast to the EU's earlier campaign—promoted by Belgium and France—to cut off bilateral meetings with Austria, because of the presence of the far-right Freedom Party in its government.

The European Commission, for its part, talks of the need for "confidence building". After lunching with Mr Mugabe in Brussels on March 5th, Mr Nielson went to talk to European parliamentarians about the EU's aid to Zimbabwe. They found him evasive. He spoke of a "choice between transparency and professional diplomacy", and made it clear that the EU intended to choose the latter. Even Britain, which has been particularly critical of Zimbabwe, has no plans to cut off its £12m ($18m) a year of aid, arguing that such an action would hurt the poor above all.

Michael Gahler, a German Euro-MP who used to be a diplomat, argues that Zimbabwe is one country where a tougher policy might have a dramatic effect. "Constructive engagement" might be the only option with a large well-established despotism, which gives little sign of instability. But the Mugabe government is vulnerable.

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The dangers of trying to help

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From The Economist print edition

THE field officer of the United Nations refugee agency was desperately trying his satellite phone when rebel soldiers burst into his house near Gueckedou, in Guinea. Mensah Kpognon had known they were coming and was trying to summon help. A visiting colleague from Côte d'Ivoire, Laurence Djeya, was hiding in the bathroom. The soldiers dragged both UNHCR workers outside, demanded money and looted the house. They told Mr Kpognon to start his car, but when he failed one rebel shot him dead. They took Ms Djeya away at gunpoint.

AP

Killed, delivering help

Mr Kpognon's murder, last year, drew little attention abroad. It came a few days after three expatriate UNHCR staff—American, Ethiopian and Croatian—were killed in West Timor, where they had been employed delivering food and medicine to thousands of trapped refugees. They too had expected an attack and had sent terrified e-mails from their office to colleagues abroad. One wrote:

> These guys act without thinking and can kill a human as easily (and painlessly) as I kill mosquitoes in my room. You should see this office. Plywood on the windows, staff peering out through openings in the curtains hastily installed a few minutes ago. We are waiting for this enemy, we sit here like bait, unarmed, waiting for the wave to hit.

Minutes later, he and the others were murdered by militiamen angry at the death of one of their own leaders. Indonesian police and soldiers, who were monitoring events, did nothing to help.

Two internal reports, assessing blame in each incident, have now been published by the UNHCR. They show that unarmed aid workers are increasingly vulnerable to violent attack. Civilian UN staff often arrive in dangerous places before peacekeepers do, and withdraw later. Too little concern is given to their security, and understaffing and poor communication make risky places more dangerous. "We are good targets, and in fact, also soft targets because there is no protection," says Benon Sevan, the UN's security co-ordinator.

Attacks on UN staff have become more threatening and more common in the past decade. According to the UN's security office, 198 of its aid workers have been murdered since the first figures were compiled in 1992. More than half were shot dead. The ethnic violence in Rwanda and Burundi alone has claimed 52 lives. In addition 240 workers (including 169 foreign staff) have been kidnapped since January 1994. In 1999 alone, 292 incidents of rape, assault, robbery and carjacking were reported.

These figures do not take into account accidental deaths, such as those of the four workers who died in January in Mongolia, when their helicopter crashed in a blizzard. They exclude soldiers killed on UN peacekeeping duty (1,654 died between 1948 and July last year). And they leave out all non-governmental organisations. Although the UN makes great use of NGO workers, and at times gives them protection, it does not publish figures if they are hurt or killed.

Mr Sevan wants to improve the safety of his staff. He points to Afghanistan, Angola, Sierra Leone and Somalia, where tighter rules, better training and a willingness to evacuate early keep down the UN casualties. And more professional guards would be useful. In both Guinea and West Timor, the ones hired by the UN ran off.

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Israel

All, or nearly all, behind the team

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From The Economist print edition

Ariel Sharon's new coalition could even last the course

THE new government of national unity under Ariel Sharon got off this week to a comfortable start. The new prime minister's policy speech was widely seen as statesmanlike, considering his hardline record and the even more extreme complexion of some of his cabinet partners. Mr Sharon was ready, he said, to negotiate "realistic political arrangements" with the Palestinians, though "not under the pressure of terror and violence". His Likud party and Labour would work together in government "like real partners". The unity alliance must usher in an era of national reconciliation.

EPA

Sharon, the conciliatory statesman

Mr Sharon did not say how he proposed to fight the Palestinian *intifada*. Labour, which holds the defence ministry, would presumably balk at any proposal to reoccupy territories held by Yasser Arafat's Palestinian Authority. Yet Mr Sharon, much more pointedly than the outgoing prime minister, Ehud Barak, lays the blame for the violence at the authority's doorstep.

The festive mood of hugs and handshakes that pervaded the Knesset as the new ministers were sworn in seemed a far cry from the atmosphere of fear almost palpable on Israel's streets. Hamas, an extreme Palestinian group, has threatened ten suicide bombs by way of welcome for the Sharon government. The first exploded in the coastal town of Netanya on March 4th, taking three Jewish lives. A Palestinian worker was severely beaten by a mob. On the streets there is a vague but intense expectation that the unity government will "do something" to reduce the violence. The government's current enormous popularity could quickly dissipate if that expectation remains unrealised.

For some, the Labour-Likud partnership has already justified its existence, by pushing through a reform of Israel's clumsy election system, devised a decade ago and regretted ever since. Hours before the new government was sworn in, the Knesset passed legislation restoring the old system. Instead of voting twice, once for prime minister and once for the party of choice, voters will again have only one ballot, which they will cast for a party, hoping that its leader will become prime minister. This ought, at least, to winnow out some of the smaller parties.

The new law comes into legal effect at the next election. But its immediate effect will be to improve Mr Sharon's prospects of staying in power until the end of the Knesset term in 2003, since his small coalition partners will be loth to bolt the government lest they disappear in a new election. Mr Sharon hopes to reinforce his eight-party unity coalition with another three small parties that found themselves edged out. The eight alone hold 78 seats in the 120-seat Knesset, leaving Mr Sharon's majority at the arithmetical mercy of Labour with its 23 seats.

In practice, the unity government's stability and longevity will depend less on the nose-count than on the viability of the Likud-Labour alliance. That, in turn, will rest on the personal relations between Mr Sharon and Labour's elder statesman, Shimon Peres, serving as foreign minister.

"We've done this before," the two old timers joked together at an informal first cabinet meeting on March 7th. They were referring to the unity government that the two of them set up in 1984, under the rotating prime ministership of Mr Peres and the then-Likud leader, Yitzhak Shamir. That government held together for six years, chiefly because the main decisions were taken in a "prime minister's forum", comprising Mr Peres, Mr Shamir and Yitzhak Rabin, far from the debating-club atmosphere of the full cabinet. Labour wants to see the same two-tier system installed again.

Even if it is, it can probably only work as long as the rupture between the Palestinian Authority and the Israeli peace camp remains unhealed. Israelis blame Mr Arafat for the collapse of the peace talks and many have come to believe that so long as he is in power there will be no further thrust for peace. This makes it possible, they explain, for Labour to take part in a Likud-led government. But several of Labour's prominent doves, such as Yossi Beilin and Shlomo Ben-Ami, still oppose the unity option.

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Iran and Russia

Friends by default

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HISTORICALLY wary of the big country to their north, Iranians harbour anxieties about President Vladimir Putin's assertive regional policy. They resent Russia's efforts to control the distribution of oil and gas lying under the Caspian Sea, and they feel sympathy for their Chechen co-religionists. Yet when Muhammad Khatami visits Moscow next week—he is expected to go on March 12th but his dates sometimes slip—he will be hoping to set the seal on what officials from both countries are now calling a "strategic partnership".

The arms trade is the cornerstone of this alliance. Iran's armed forces need new kit, which the United States and Europe refuse to supply. Russia's struggling defence industry needs hard currency. Shortly before Russia's defence minister visited Tehran last December, the Russian government declared invalid a previous secret undertaking, given to America, that it would suspend arms sales to Iran. Since then, officials from both sides have said that Iran might buy equipment—probably air-defence missiles, helicopters and attack aircraft—worth at least $2 billion.

The two countries have discovered common interests. Before Mr Khatami's election in 1997, the hardliners then running Iran thought of friendship with Russia as a way out of international isolation. Russia, they reasoned, would supply arms and diplomatic favours, and not ask awkward questions about human rights. Russia, for its part, saw the wisdom in cultivating a regional power that lay outside the orbit of the United States.

Since then, the two have united to help Afghan groups opposed to the ruling Taliban, and to express their disquiet at NATO's eastward expansion. Iran has obligingly bitten its lip on Chechen atrocities. A shared antipathy for American intervention in their areas has camouflaged points of conflict. Although Iran and Russia both want the main pipeline that will take Caspian oil to western markets to go through their own territory, they have come together hoping to resist American attempts to make sure it runs through neither (see article). And there is a chance, at least, that Mr Khatami and Mr Putin will use their forthcoming meeting to reach an agreement on how the Caspian Sea itself should be shared among its five littoral states.

In theory, George Bush should be able to cool this budding friendship. Mr Khatami's undeclared foreign-policy goal is not so much to improve relations with Russia as to reopen ties—first economic, then political—with the United States. There was alarm in Moscow last year when Bill Clinton lifted American sanctions on some Iranian goods, and when his secretary of state carefully acknowledged a history of American meddling in the region.

But, whatever Mr Bush's scepticism about the usefulness of sanctions, he is unlikely to pursue a softer policy so long as Iran is suspected of using Russian technology to develop nuclear and biological weapons, devices that Iran's ballistic missiles might be capable of delivering to Israel. Meanwhile, Mr Khatami's precarious domestic position—he is pecked by hawks—means that he is ill-placed to coax Mr Bush into friendly gestures. So Iran's friendship with Russia has acquired a momentum of its own.

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Congo and Rwanda

Marching out, and in again?

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From The Economist print edition

Get article background

AFTER more than two years of war, it is understandable that the slogan of the moment in Congo is to give peace a chance. Sadly, peace for this sprawling central African country requires a miracle, not a chance.

Last week, true to its word, the Rwandan army pulled back 200km (125 miles) from its frontline positions in Pweto, a city in Katanga province. Between 2,500 and 3,000 Rwandan troops clad in gumboots marched back in single file to calls of encouragement from their senior commanders. Rwanda calls this retreat "a goodwill gesture", since it goes well beyond the terms of the 1999 Lusaka peace accord that called for a first-stage 15km withdrawal by all parties in the Congolese conflict.

As the first group of Rwandan troops withdrew to Pepa, Rwandan-backed Congolese rebels occupied the vacated positions. The rebel chief of staff reported that the Kinshasa government was strengthening its forces on the other side of the front line. He said that 2,500-3,000 reinforcements had taken up positions around Lukonzolwa, some 50km along the shore of Lake Mweru from Pweto. They were, he said, a mixture of *Interahamwe*—the Rwandan militiamen who carried out the 1994 genocide—and a Burundian rebel group based in Lubumbashi, the capital of Katanga province.

Probably, at this juncture, Rwanda is sincere in its wish to withdraw from Congo and would be relieved if it were able to pull out completely. But it can afford to do so only if its own border security—concern for which prompted its entry into Congo in 1996—is resolved. All parties to the conflict are supposed to submit plans for disarming the militia groups, including the *Interahamwe*, by the middle of May. But if Rwanda has not yet succeeded in disarming the *Interahamwe*, the chances of anyone else doing so are slim. Nor, for that matter, with peace still remote, is it rational to expect the other half-dozen armed groups running around eastern Congo to agree quietly to lay down their arms.

The Rwandans argue that, if the Congolese government withdrew its support in arms and supplies from the *Interahamwe*, the militia's military capacity would shrivel. But, despite declarations by Joseph Kabila since he took over as president in January, Congo's support appears to continue.

United Nations peacekeepers have begun to deploy in Congo. The original mandate of 5,500 military observers has been cut to 3,000 and a handful of these, to be based in Pweto, are already struggling against impossible odds. How, indeed, can four men watch over a 100km swathe of countryside, dotted with burnt-out villages and two days' drive from the nearest safe airstrip?

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The sky's the limit

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From The Economist print edition

Airlines are making money again, but they are also making their growing number of passengers miserable. They need to find ways of doing the one without the other, says Iain Carson

AP

CIVIL AVIATION is a tale of two contrasting trends: one is strong growth in sales and profits for the world's airlines, the other is increasing misery and dissatisfaction for travellers, especially in America and Europe. For an industry that collectively lost $15 billion in the first few years of the 1990s, the past five years have brought a welcome change. The net profits of all scheduled airlines worldwide rose from $4.5 billion in 1995, when the boom began, to $8.5 billion two years later. Although in the past few years profits have been dented by the knock-on effects of the Asian crisis and the tripling of oil prices, they remain substantial. However, the airlines are having to work harder and harder for them. The average consumer is paying 70% less per passenger-mile in real terms than 20 years ago, and revenue per seat is declining by an average of 2% a year.

At the same time consumer dissatisfaction with air travel has reached a new peak in America after two summers of appalling disruption. Hardly a day goes by without some congressman berating the airlines for their general inefficiency, their callous disregard for passengers, and their greed in gouging business travellers with steep fare increases on popular routes. Hollywood has even started making movies that incorporate the horrors of air travel in the plot. For American consumers, airlines have taken over from HMOs (the controversial health-care companies) as public enemy number one. The announcement last May of a merger between mighty United Airlines and its smaller rival US Airways met with universal hostility. Seeing what a poor job the airlines were doing, Americans refused to believe that bigger would mean better.

Moreover, the airlines are now being attacked by environmentalists for contributing to global warming as well as causing noise pollution around airports. Although jet engines today are much quieter than they were even ten years ago, the huge rise in the number of flights makes the problem more pervasive. To cap it all, consumer groups are now lambasting airlines for squashing in too many people. Sitting still for long periods in cramped conditions, they say, can cause a condition known as deep-vein thrombosis (the formation of potentially lethal blood clots). Some carriers, including American Airlines, are taking out a few rows of seats to create more space for economy passengers to move around in. But dissatisfaction keeps rising.

Why is the industry failing to keep its customers happy? One answer is that it has been growing so fast, even in a supposedly mature market such as America, that the airlines, and the air-transport infrastructure of airports and air-traffic control, have simply not been able to keep up. Although the airlines like to say that 70% of delays are caused by the weather (ie, are not their fault), many of these delays could in fact be avoided or shortened if the system worked better.

But consumer pressure in response to gridlocked skies is only one force for change in the air-travel industry. Equally important are the parallel trends of privatisation and liberalisation, which are proving unstoppable. In America airlines have always been private, but elsewhere one national flag carrier after another is passing from government ownership into the private sector. The 70-odd airlines in which governments still have a majority stake will gradually be sold off. In the past few years the biggest wave of privatisation has been in Europe. National carriers such as Germany's Lufthansa, Air France and Spain's Iberia have all been opened up to private capital, following the example of British Airways, which was sold off in 1987. Now Asian airlines may be going the same way.

As governments are relieved of the burden of financing the investments of these often loss-making concerns, they become less anxious to protect them with rigid bilateral air-traffic agreements. This has already led to liberalisation in Europe (some 20 years after America), and is progressively opening up

other international routes. Liberalisation within Asia is also proceeding rapidly. The combination of privatisation and liberalisation has created a new force for change. As Chris Tarry, transport analyst at Commerzbank in London, points out, airlines are no longer just chasing increased revenues or market share: “Shareholder value is increasingly seen as the key performance driver.” In other words, airlines have joined the rest of the business world.

It is a puzzling paradox that an industry which has done so much to foster globalisation has itself been stuck in a regulated environment with a purely national ownership structure and protectionist trade rules. In 1945 the number of passenger journeys made by air was only 9m; last year it was over 1.6 billion. Some 40% of the world’s manufactured exports (by value) is transported by air. In order to serve businesses that operate on a global scale, the airlines are having to find ways around the constraints. Multinationals with factories and offices around the world want one-stop shopping with an airline that can send passengers to any corner of the globe. This has prompted the creation of airline alliances, which attempt to weave the operations of separate airlines into a coherent network but stop short of full mergers.

The number and shape of such alliances will be governed by another force for change—the consolidation of the industry that is now under way in America. As America scales down its Big Six list of top airlines, the world is likely to end up with three or four big alliance groupings. “The number of alliances will be as many as there are large US partners,” says Friedel Rödig, who ran the Star Alliance (dominated by United Airlines and Lufthansa) until last month. “It is vital for each alliance to have a footing in the US.”

This may look like a worrying return to the oligarchy in the airline industry that prevailed in America before deregulation in 1978. But alongside the mainstream carriers and their alliance partners now fly the low-cost carriers, such as Southwest Airlines and Jet Blue in America, and EasyJet and Ryanair in Europe. They offer an alternative model of air traffic—short-haul, point-to-point flights—which has been so successful that it is now exerting further pressure on the mainstream carriers to shape up. Southwest and Ryanair have the highest margins and returns on assets of all the airlines.

Wonders of the web

The Internet is also beginning to reshape the industry. Already airline tickets are the biggest-selling commodity on the web. For some budget carriers, online sales now make up 90% of the total, although for mainstream airlines the share is still below 5%. One big advantage of the Internet is that it gives consumers access to better information about what is on offer. Conversely, as more people buy their tickets online, the airlines get to know more about their customers’ needs and preferences. By hooking up powerful databases to interactive websites, they can dive deeply into “customer relationship marketing”, as it is known in the jargon. The idea is to bind a customer into travelling with your airline, rather than anyone else’s, by offering tailor-made deals reflecting his known preferences.

The Internet will also change the passenger’s experience of a flight. With online or telephone booking ever more prevalent, paper tickets are becoming redundant. Bob Crandall, a legendary boss of American Airlines (now retired), used to lament that airline passengers turned up at the airport anxious to do one thing—board the aeroplane—only to find they had to face barrier after barrier, as if the airline was trying to stop them. Now, on many airlines, passengers need nothing more than some form of identification, a

code number and/or their credit card to board the aircraft. The Internet will invade the aircraft cabin itself, too, along with live television, as broadband connections start to be offered.

Other than that, no great technological leap awaits air travellers. Ten years hence, aircraft will still be metal tubes with wings and lots of seats. But the queues might get bigger with the arrival of the new double-deck superjumbo, the Airbus 380, capable of carrying 550 passengers in its first version but perhaps up to 800 later. Boeing does have a revolutionary “blended wing body” (BWB) aircraft undergoing model-flying tests, but that is still a long way off. The concept of the “flying wing” was developed over 50 years ago, but up until now it has been used only for military aircraft such as the stealth bomber. In theory, its superior aerodynamics could cut fuel costs by up to one-third.

Will such aircraft sell in large numbers? It depends on which way the industry goes. If today's regulated structure prevails, then huge aircraft will have the advantage. But if globalisation and deregulation make it easier for airlines to fly direct to any destination without going through big international hubs, the giant Airbus may have less of a role.

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Opening wider

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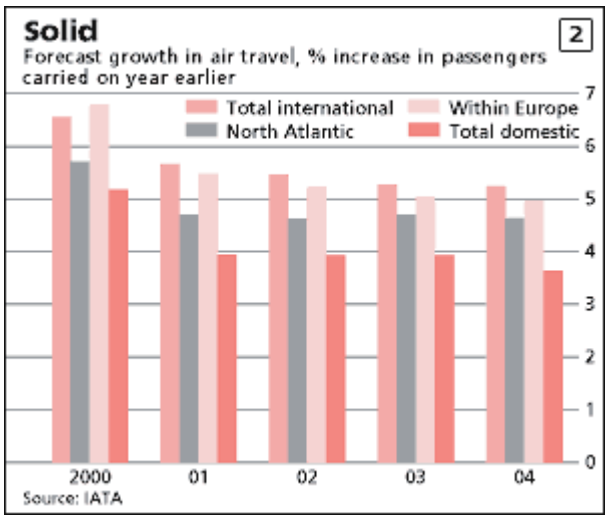
But not wide enough yet

THE die was cast for aviation in 1944, at a 52-nation conference called the Chicago Convention. The United States wanted global open skies (on its terms, of course) for the new civil-aviation industry that was bound to emerge from the technical advances of military aerospace. But, perhaps because of the wartime setting, almost all the other nations identified aviation with national security; so they went for a regime based on national ownership and a system of designated flag carriers. Their operations would be governed by bilateral air-service agreements that would regulate which airlines flew where, when, and at what fares. Technical and safety matters would be taken care of by a new body, the International Civil Aviation Organisation (ICAO), part of the United Nations.



The result was a highly regulated industry, but at least it worked. Aircraft became more reliable and safer, especially after jet engines came into widespread use with the Boeing 707. Passengers could buy one ticket that was valid for different legs of a journey on different airlines. This “interlining” was made possible because airlines could pool revenue (with the notable exception of routes to and from America) and discuss fares so that they could agree on the value of each part of the journey.

Unfortunately this system, organised under the auspices of the International Air Transport Association (IATA), also encouraged collusion on fares, which tended to be set behind the potted palms at IATA conferences rather than by the free play of market forces. Pierre Jeanniot, IATA’s director-general and a former boss of Air Canada, recalls the early days of the IATA system. “In those days an airline was driven by operations [the practicalities of getting people from A to B on time],” he says. “With traffic growing at 15-20% a year, there was no marketing. That came only in the 1970s, once natural growth slowed down and there was competition from the likes of Freddy Laker and Max Ward [of Wardair].” But in the early 1990s the old IATA system began to crumble. Under Mr Jeanniot’s leadership, the organisation has now become a champion of market forces. It even wants to have air-traffic management run by commercial service providers.

In America in the late 1970s President Carter’s administration pushed for deregulation in the internal market, in response to the growing consumerism of the time. The airlines fought it fiercely until United Airlines broke ranks to support the plan proposed by Fred Kahn, the economist advising the White House on this matter. Hundreds of small start-up airlines rolled down the tarmac, most of them to disappear without a trace. The most significant survivor was Southwest, which had been operating only in Texas until deregulation allowed it to spread its wings.

Europe took 15 years to follow American deregulation, but given that most European airlines were still state-owned when the process began there in 1993, its progress has been remarkable. Since the mid-

1990s airlines have been able to fly virtually anywhere they want to within the European Union. Airlines from one EU country, such as British Airways or KLM, are also free to set up in another—as indeed both these carriers have done.

In the early 1990s the Americans launched a rolling programme to create “open skies” with as many countries as would agree to liberalise their traditional bilateral air treaties with the United States. The basic template was to allow any airline in each of the countries to fly between the two countries with minimal restrictions. Routes, frequencies, fares and schedules were all up to the airlines’ commercial judgment. In the open-skies deals with Germany and the Netherlands, the Americans even conferred antitrust immunity on the pooling of revenues, schedules and fares between airlines within an alliance. In all, some 40 such deals were struck around the world, and they undoubtedly prised open international aviation.

Free, up to a point

That was a laudable cause, but it is fair to say that the Americans also had another purpose in mind: to promote the interests of their own carriers. All the deals were between America, a country that accounts for over a third of the world aviation market, and one with a much smaller share and usually only one international airline. The main bone of contention is the right to pick up traffic in the destination country and either fly it on to another destination within that country (known as “cabotage”), or to a third country (“fifth freedom”). Rigas Doganis, an aviation consultant, explains the problem in an excellent new book (“The Airline Business in the 21st Century”, Routledge):

> While US carriers can fly from any airport in the United States to a wide range of airports in the EU, European airlines can only operate to the United States from their own country. Consequently they cannot exploit fully the whole EU market of 360m passengers...In addition, US carriers obtained and in many cases used extensive [fifth freedom] rights between European points which are now essentially domestic sectors within the European Union. Yet European airlines cannot enjoy the equivalent rights to serve city pairs in the United States.

In other words, the mighty United States has picked off European markets one by one while preventing foreigners from owning airlines in America and stopping them from picking up passengers at more than one American city. In the past year the European Commission has launched legal proceedings against the eight open-skies deals America has with EU countries, on the ground that they are against EU single-market rules.

But the Europeans have only themselves to blame, because their governments have refused to delegate negotiating powers for aviation to the European Commission. However, in the past 18 months the European airlines have suddenly come round to favouring a deal with America, code-named the TCAA (transatlantic common aviation area), which is now being promoted by the EU transport commissioner, Loyola de Palacio. If a TCAA ever comes about, it will liberalise air travel between the world’s two biggest regional markets. It will also encourage Asia, which plans to move swiftly towards regional free trade in aviation.

The big obstacle to a TCAA is a long-simmering row between those two champions of free trade, America and Britain. As things stand, only two American airlines—United and American—are allowed to fly into London’s Heathrow; the rest must use Gatwick or provincial airports. By contrast, British Airways can fly to two dozen American cities. This imbalance causes American airlines huge irritation. But the British will not loosen up crowded Heathrow unless America allows British airlines to own carriers there (where at present they can hold only a quarter of voting shares) or fly people around America on the way to and from Britain.

This stand-off has been going on for nearly ten years, and has prevented an alliance between BA and AA from graduating to a virtual merger. Competition authorities on both sides of the Atlantic were concerned that the two airlines together would have a virtual monopoly on several key transatlantic routes. Now the chief executives of BA and AA, Rod Eddington and Don Carty respectively, will make another attempt to persuade the authorities to consider the competition issues in a wider context, rather than looking only at the traffic between London and New York.

Regional free-trade areas are always second-best to free trade all round, but in the world of aviation they are a big step forward. The creation of a TCAA would be a very big deal indeed, because it would create a

free-trade zone for two-thirds of the world's air travel. But unless and until it can be achieved, the only way that airlines can hope to offer a global service is through alliances.

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Huddling together

Mar 8th 2001
From The Economist print edition

The loneliness of the long-distance carriers

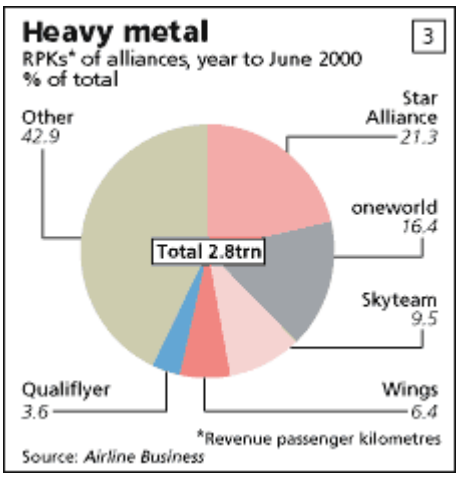
MICHAEL PORTER, a Harvard management guru, once observed that alliances tended to be “transitional devices”, most often found in “industries undergoing structural change or escalating competition, where managers fear that they cannot cope”. Remember that next time someone makes fancy claims about seamless global travel with this or that airline alliance. However, the aviation industry’s excuse for resorting to alliances is better than most: the rules that forbid foreign takeovers and deny foreign airlines the freedom to operate within other countries’ domestic markets are indeed a serious obstacle to the industry’s efficient operation.

The 580 alliances, involving 220 airlines, recently counted by *Airline Business*, a monthly magazine, include a vast range of different arrangements. At the most basic level, an alliance may be simply a joint marketing deal known as code-sharing, in which two airlines put both their identification codes on a flight and they both sell it, even though only one operates it. This also allows the allied pair to label two flights they operate separately as if they were a through flight, automatically taking it towards the top of the computer-reservation-systems list, which always favours direct flights. Naturally the pair pledge to smooth the way for the transfer passengers, but it does not always work.

The next step up from simple code-sharing is block-booking on each other’s flights, which means each airline has a certain number of seats to sell on its partner’s flights. After that comes joint marketing of the two airlines’ network routes and sharing of frequent-flier schemes. In the closest form of alliance, a pair of airlines, such as KLM and Northwest—the best example at present—completely integrate their business. The next step up from this would be a complete merger.

Sitting above these bilateral arrangements are the grand alliances that gather whole groups of airlines under one umbrella. The biggest of these is the Star group, which brings together United Airlines, Scandinavia’s SAS, Lufthansa, Singapore Airlines and nine smaller partners, and accounts for over 20% of world air traffic (see chart 3). Next comes the oneworld grouping around AA, BA and Hong Kong’s Cathay Pacific, with about 16% of traffic. The other two big alliances are Skyteam (Air France and Delta) and Wings, essentially the Northwest-KLM pairing.

For Mr Eddington, the chief executive of BA, who in his previous job as boss of Australia’s Ansett Airlines spent three years in the Star grouping, the most important aspect of these alliances is the large number of bilateral code-sharing and marketing deals within such groupings. Mr Rödig, Star’s original chief executive, agrees. By ranging themselves under one banner, the individual airlines walk a tightrope between promoting the alliance brand and sustaining their customer appeal. “You could say the airline brand is compromised,” Mr Rödig admits. “But the idea of Star is to do together what one carrier cannot do.” As an example, he points to the 500 airport lounges available to passengers through membership of the frequent-flier programme of any Star member.



Equity stakes don’t count

Until a few years ago, cross equity holdings were considered an essential cement to bind alliances into a stable relationship. But that theory exploded in June 1999 when Singapore Airlines deserted its partners Delta and Swissair in the earliest global alliance to join Star, even though the original trio held small stakes in each other. For Mr Rödig, the more important binding force is a gradual integration of systems and sales. “Once you get that, you have de facto stability,” he says. Indeed, the boss of Swissair’s parent, SAir group, was fired in January after his board reversed the airline’s expensive strategy of

buying stakes in a number of ailing airlines as a basis for forming a European regional alliance.

For Mr Doganis, the key distinction is between alliances that are purely commercial and those that are more strategic: “A strategic alliance is one where the partners co-mingle their assets in order to pursue a single or joint set of business objectives.” Such assets may be terminal facilities, maintenance bases or aircraft. He points out that many of the big airlines’ franchise deals with smaller feeder carriers are strategic, despite the difference in size, whereas code-sharing, block-booking or frequent-flier-sharing deals are essentially marketing arrangements.

All the same, these marketing arrangements are important in winning and holding on to business customers, who usually travel under corporate deals exclusive to one airline. “Alliances give you network scale, and network scale has become more important to customers as business has gone global,” says Henry Joyner, senior vice-president for planning at American Airlines in Dallas. “The business customer used to worry about you being able to fly him to the plant in Baton Rouge in the American South. Now he wants you to get him to the CIS, China or Brazil.” For Gordon Bethune, boss of Continental airlines, the big pay-off from its alliance with Northwest is “the ability to sell tickets to passengers travelling through their Tokyo hub onwards around Asia”.

For the passengers, the benefits of alliances are the chance to earn frequent-flier benefits across a wider network; smoother transfers to a wider range of destinations; and access to premium lounges at transfer airports. In some circumstances, alliances may even bring down fares. A study by two academics (“The Price Effects of International Airline Alliances”, by Jan K. Brueckner and W. Tom Whalen, University of Illinois, 1998) claims that by using United’s Star alliance, travellers between Scandinavia and the American mid-west could save up to 28%, compared with booking through non-allied airlines. This applied to three-flight journeys which involved a leg behind the gateway airport on each side of the Atlantic. Each carrier would extract less than the maximum revenue from its leg so as to stimulate traffic and thus maximise the alliance’s overall revenue. However, for flights between gateways such as London and New York, alliances tend to raise prices by about 4% because they reduce competition.

But the idea of cheaper “interline” fares using allied rather than separate carriers makes one veteran aviation economist scoff. Adam Pilarski, now a senior vice-president with the Avitas consultancy in Washington, DC, after 17 years as head of economics and forecasting at McDonnell Douglas, wanted to fly from Washington, DC, to Oslo about 18 months ago. He asked his agent for the cheapest economy-class fare, transferring in London, and was quoted $1,500 for flying United all the way. He knew that United does not fly between London and Scandinavia, so he asked the agent to look again, and got a different quote. Flying United to London and SAS onward to Oslo, and the same in reverse on the return leg, he would be paying just over $1,000. He checked the flight times and found that he would be travelling on exactly the same flights. The only difference on the more expensive trip was that all the flights would be labelled United.

For a long time, the worst thing about alliances was the opacity of code-sharing. Passengers would book on one airline, only to find they were flying on another. A few years ago a passenger might have bought a ticket from London via Paris to Seoul in South Korea, thinking he would be flying Air France. Instead he could have ended up on Korean Air, which at that time had a dreadful safety record, causing great embarrassment to its alliance partners.

Most airlines are resigned to working within alliances, even though they may have trouble maintaining consistent service quality: the big ones account for nearly 60% of all travel. Only a handful of big carriers stay aloof, and then usually for good reasons: America’s Southwest Airlines, for example, needs no alliance because it runs a purely domestic network. A couple of years ago, when Singapore suddenly quit its Atlantic Excellence alliance for Star, that put an end to its former partnership and prompted the formation of Skyteam in its place. Last May KLM fell out with Alitalia, dashing its hopes of developing its Wings alliance. There is still plenty of scope for promiscuity behind the hangars before aviation becomes a mature, consolidated industry.

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The joys of oligopoly

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From The Economist print edition

Is consolidation in the American market a good thing?

NO SOONER had it become clear that George Bush really would be America's next president than United Airlines, American Airlines, US Airways and TWA unveiled their latest plan for carving up the American market between them. United's controversial proposal to take over US Airways had been under scrutiny by the previous administration since May last year. The twist added in January was American Airlines' plan to take over TWA, which was going bust anyway, and to acquire chunks of US Airways, mitigating the blow to competition from the proposed United/US Airways merger. The rescue of TWA might also placate the antitrust authorities over the United merger, because it would make it part of a four-company rationalisation plan. Antitrust regulators tend to smile on deals that involve the acquisition of failing enterprises. A decision on the merger is expected later this month.

AP

Push-back time

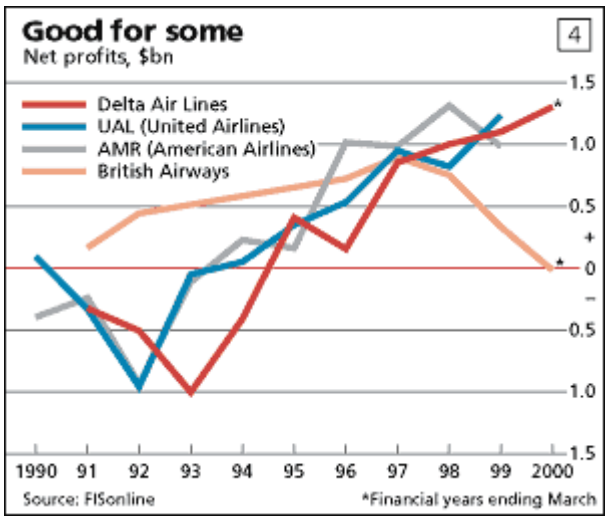
Why should American Airlines want to help its arch-rival? For a start, it had to do something in response to the United merger. "In a network business you cannot let your competitor get ahead with a much bigger operation," explained one of its managers. But the plan is more devious than that, and to many old hands it looks like history repeating itself. Back in 1978—in the aftermath of deregulation in America—United and American (which along with TWA and the now-defunct Eastern Airlines made up the industry's Big Four at the time) both decided that growing to a national size was the only way they could deal with recalcitrant labour and compete with lower-cost newcomers. United quickly positioned itself as the only carrier flying to all 50 states. American moved to spacious Dallas-Fort Worth airport as a central location from which to fan out over the whole country. But the pair never quite achieved the duopoly they sought.

Instead, airlines such as Delta, Northwest, Continental and US Airways each built up their own hub-and-spoke networks based on regional cores: Delta in Atlanta, Northwest in Detroit, Continental in Houston and so on. Travellers in most cities could choose from about six ways to get to their destination via different hubs. Those living in a hub city would be able to fly direct to about 80 destinations. Business travellers would generally have little trouble moving around the country, and would not miss out on their frequent-flier programmes if they used two different airlines. No single airline held a dominant position with a complete national network.

But now United and American Airlines are trying to redraw that pattern. As the opposition to the United/US Airways deal mounted, American Airlines' boss, Don Carty, spotted his chance: by rescuing TWA from bankruptcy, he would be able to pick up parts of US Airways' east-coast business that it might have to relinquish to satisfy the antitrust authorities. This attempt at consolidating the American industry into a tight oligopoly of national networks is unfinished business from 20 years ago.

An air of crisis

All this is happening at a time when the airlines, after a long period of losses, have at last been making good profits for the past five years or so. Yet they are more unpopular than ever. The air is thick with calls for re-regulation, as well as for a charter to enshrine passengers' rights. The American media are full of stories about airports strewn with exhausted travellers who cannot get off the ground. For most families, the annual trek to see the folks for Thanksgiving has become an ordeal.



Part of this can be explained by a cumulation of bad luck. There was the horrendous winter two years ago when airlines such as Northwest collapsed under two feet of snow in the mid-west, followed by two awful summers, 1999 and last year, when botched changes to air-traffic control and a work-to-rule by United pilots respectively had air travellers tearing their hair out. There were tales of pilots making unscheduled landings, leaving passengers stranded thousands of miles from their destination, or dashing off for a hamburger before take-off because they did not like the airline food. Passengers just had to suffer in silence.

But some of the problems are structural. For example, many American business travellers want to leave home early in the morning and fly up to 500 miles for a day's work in another city, then return home the same evening. That is asking a lot of an airline system in a country where the weather can bring whole chunks of the network to a halt; yet the airlines, anxious to grab their share of this profitable business traffic, do not like to admit that they cannot deliver.

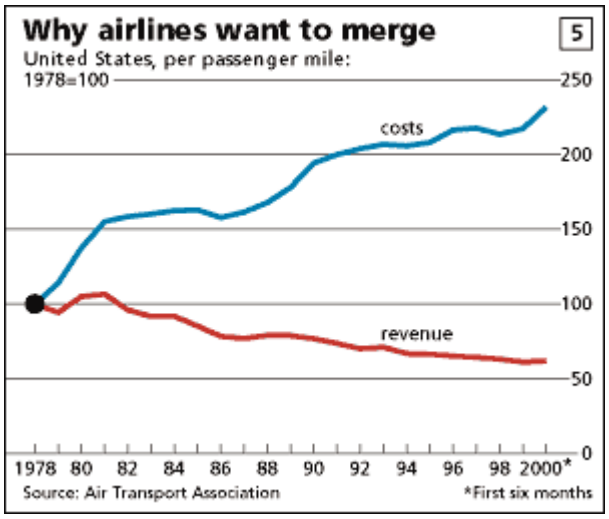
So at a busy hub airport, all the airlines schedule their flights for, say, 8am, the most popular morning departure time, knowing full well that only about eight of the 40 flights aiming for the slot will take off within 40 minutes of that time. They have even invented a new term, "push-back time", to provide themselves with an excuse. Passengers who complain about delays are told the aircraft pushed back from the gate on time, so the delay is the fault of air-traffic control. If a flight leaves the gate within 15 minutes of its scheduled departure time, the Department of Transportation considers that it has left on time, no matter how long it waits on the tarmac before taking off.

One way around the horrors of flying via congested hubs is to use the low-fare, no-frills services offered by carriers such as Southwest Airlines. These operate point-to-point, using secondary airports, where Southwest saves money on landing fees and passengers have a better chance of avoiding delays. Southwest's traffic and business model is quite different from the big airlines' hub-and-spokes system, which feeds traffic into hubs where it can be decanted into larger aircraft and flown on to other hubs, or else redirected along another spoke to a smaller destination. The passengers suffer the inconvenience of having to transfer, or waiting in the aircraft at a hub stop, but get a more comprehensive network and greater frequency of flights. The airlines also try to schedule outgoing flights to leave within a couple of hours of incoming traffic to keep down waiting times.

The point-to-point service that Southwest offers can be more expensive to operate, because connecting a given number of cities by direct flights needs more flights than if one is designated a hub. But Southwest concentrates on routes where it can sell enough seats to people going only from A to B, and it can keep the cost down by getting more flights per day out of each aircraft and its crew. Instead of sitting around at a hub, waiting for connecting traffic, the aircraft take off again 20 minutes after arrival. Thanks to low fares and slick marketing, the flights get filled; and thanks to lean staffing and the absence of frills, operating costs are low enough to overcome the disadvantage of having to have more flights than with a hub system.

The big hub airports of the mainstream airlines have a built-in tendency to aggravate delays in several ways. One is the sheer concentration of flights and passengers coming in and going out at peak times, making it difficult to handle the volume of air traffic, especially when flights have to be spaced further apart than normal because of bad weather. Also, to minimise hanging around and to schedule overnight maintenance at a handful of centres around the country, airlines rotate their aircraft in a circuit around America over the course of several days. So an aircraft held up by snow in the mid-west in the early

morning can fail to arrive in sunny Phoenix in the early afternoon and will therefore not be available to go on to blazing Tampa. Naturally, people who get held up by these knock-on effects find it hard to believe that bad weather somewhere else is responsible. They just think the airline has screwed up.



There are ways of mitigating such effects. For example, the Chicago hub, the airport most prone to winter disruption, has been sealed off by American Airlines from the rest of the system; aircraft that run in and out of there are now confined to that part of the system and not allowed to move on elsewhere. It means their utilisation is less than optimal, but it avoids the cost of nationwide disruption for the airline when Chicago's O'Hare airport once again disappears under a blanket of snow.

Whatever its disadvantages, the hub system does offer travellers greater frequency, more destinations and lower fares than they could expect without it. Overall fares in real terms have fallen by 20% over the past ten year, but that average covers a huge variety of different fares, from the cheapest advance-purchase rate to the last-minute walk-up one at 10-20 times as much. Consumers have been infuriated by a recent rise in flexible and business fares, and continue to be subjected to some irritating practices. As an example, Mr Pilarski of Avitas points to the Saturday-night rule. A business traveller from Washington, DC, to San Francisco pays $543 return to fly out on a Saturday and come back on, say, the Monday. But if he chooses to spend Saturday night at home and fly out on Sunday for a business meeting on Monday, the fare goes up to $2,248. If he is canny, he will buy a one-way ticket for his Sunday departure ($1,124) as well as the cheap return ticket at $543 of which he will use only the return leg, thus saving $581. Corporate discounts of up to 40% can help, but consumers are disgruntled.

Good or bad for competition?

If the proposed consolidation goes ahead, will it make things better or worse? Apologists for consolidation reckon that it would lead to the emergence of three or four mega-carriers with national networks. Continental and Delta, which failed to merge three years ago, are thinking about trying again. They would form the third big carrier, possibly even joined by Northwest, which could hardly survive on its own. In addition, there would be Southwest with its own national no-frills network. Darryl Jenkins of the Aviation Institute at George Washington University thinks everyone underestimates the degree of competition provided by Southwest, which he considers the best antidote to consumer fears about consolidation among the mainstream airlines. He also argues that the stimulus to traffic from consolidation into powerful nationwide networks would benefit consumers as well as airlines. Consumers would be able to choose between three competing networks plus Southwest, which now covers most of the country.

But Mr Jenkins's theory about the benefits of the United merger for Southwest crashes and burns at Love Field airport outside Dallas. "It's ridiculous," says Gary Kelly, Southwest's chief financial officer. He thinks the merger is just another attempt to stifle competition. On the other hand, he does not believe it will hurt Southwest much. "Our costs are half of theirs, and we are the most profitable airline," he says. Southwest was still racking up a 35% increase in profits in the fourth quarter of last year, even as the big airlines' five-year run of fat profits collapsed under the weight of fuel costs, weather disruption and labour problems.

By contrast, the Economic Strategy Institute (ESI), based in Washington, DC, is a strong advocate of the

United/US Airways merger. Having studied the 197 American airports with more than one carrier, it concludes, somewhat surprisingly, that as a result of the merger competition would increase in 74% of them, stay the same in 13% and decline in only 13%. The ESI concludes that consolidation will intensify competition, increase traffic, improve access and broaden commercial opportunities. Another thumbs-up for the merger comes from Steven Morrison of Northeastern University in Boston, who estimates that although low-cost carriers such as Southwest fly only 12% of total passenger-miles in the domestic market, their influence is much wider, affecting fares across 94% of the market.

To reach this conclusion, he counts in competition on the routes themselves, competition on nearby routes and potential competition, stretching the theory of “contestable markets” to the limits. United could hardly have paid for a more ringing endorsement. But not everybody agrees. A study of both mergers’ effects by the General Accounting Office for Congress found both good and bad in them. The authors reckoned that it would reduce competition on 300 routes, affecting 10m passengers, but increase it on a few others, and would improve connections to big hubs for some travellers.

Michael Levine, a Harvard academic and a former senior manager at TWA, sees the merger as an attempt by United and American Airlines to extract higher fares. He discounts much of the competition from Southwest, arguing that the airline’s use of secondary airports far from city centres makes it much more suitable for the tourist with time to spare than for the business traveller. Moreover, if the mergers succeed, he says, Southwest too will have more scope to raise fares. He also points to the two airlines’ poor labour relations, which often mess up whole sections of America’s air-travel system even now. Mergers seldom improve labour relations, and if the two airlines controlled half the system, the potential for chaos would increase immeasurably.

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Let fly

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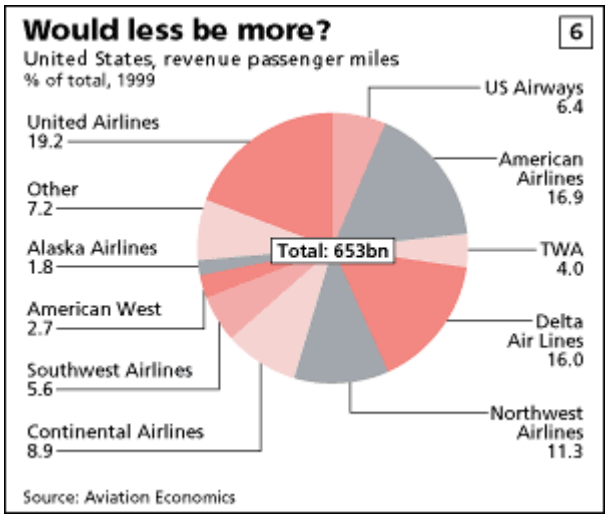
From The Economist print edition

Much of what is wrong with American aviation could be fixed by allowing real competition



WHEN a left-leaning consumer organisation and a free-market think-tank come up with similar solutions to some of American aviation's problems, it is time to pay attention. The Aviation Consumer Action Project (ACAP) and the Cato Institute have both come out for opening America's skies to foreign airlines and foreign capital. "Opening US skies would inject capital and competition into the US aviation market, leading to even lower fares and improved service," writes Kenneth Button, an academic and former head of aviation policy at the OECD, in a Cato pamphlet. A few years ago Britain's Virgin Atlantic proposed running low-fare services from 20 American cities to feed into its international routes operating from New York and Washington, DC. But the airline could not get round the American rule that limits foreigners to owning 25% of voting shares in an American airline. The same restriction had frustrated British Airways in the early 1990s when it held shares in its alliance partner, USAir (as it was then known), and eventually the partnership was dissolved.

For Paul Hudson, executive director of ACAP, "protectionism is driving the current consolidation." He feels that TWA, with its well-established holiday flights to Europe and the Caribbean, might have attracted foreign capital instead of having to go bankrupt and being rescued by American Airlines. That might be wishful thinking, but it is worth noting that a minority shareholding by KLM saved Northwest Airlines from bankruptcy in 1989, and that a stake in US Air held by BA tided that airline over a difficult financial period in the early 1990s. Mr Button, for his part, is convinced that foreign competition and investment would provide "the ultimate free-market check on predatory pricing and domestic price collusion, and would negate any arguments for imposing federal price regulations and antitrust sanctions".

Mainstream airlines are frequently accused of dropping prices and flooding markets with capacity when a low-cost new entrant comes along. Once the newcomer has retreated, capacity drops and fares rise again. America's Justice Department still has a case outstanding against American Airlines for doing this at Dallas to crush a start-up called Vanguard Airlines. American Airlines claims this was just normal competitive behaviour. Apologists for the big airlines say the real reason why so many start-up airlines fail is that they lack sufficient finance to stay the course. Again, people such as Mr Hudson argue that letting in foreign capital could plug this gap.

But foreigners are not only prohibited from owning airlines in America; they are not allowed to operate any services either. BA, for instance, may fly international services into 25 American airports, but it cannot pick up extra passengers at, say, Kennedy Airport, to fill up emptying seats before going on to Los Angeles. American carriers, on the other hand, are free to do this within the European Union. America's restrictions go back to the Jones act of 1920, which limited coastal shipping to vessels built, owned and crewed by Americans. This was to promote a well-equipped and modern merchant marine for use in the nation's defence and for promoting commerce.

Shutting out foreigners does not just restrain competition in the American domestic market, it hands American airlines an advantage on international routes. They can feed their international services from the spoke routes running into their hubs, making it easier to fill their flights, whereas the Europeans have to rely on local traffic at the gateway city they use, usually on the east and west coasts. Mr Hudson sees this as an implicit export subsidy. He draws a parallel with Japan in the 1970s, when Japanese-made television sets would sell for $500 in the low-competition domestic market but for half that price in the highly competitive American market.

Network economics

Nor is it only foreigners who are shut out of American aviation. The networks and the airports also discriminate against new entrants, certainly at big airports, where most of the traffic is concentrated. In touting their merger proposals, the bosses of United and American Airlines like to talk about network economics. If they get their way, United/US Airways and American Airlines with TWA will have at least half the market in the United States. They say that larger, truly national networks confer benefits on consumers as well as on the companies concerned. According to this argument, known to economists as Metcalfe's Law, consumers will pay a lot more for access to a network as it expands, because it becomes disproportionately more useful to them as it grows. Nobody will pay much for a telephone service that hooks up just two people living on opposite sides of the country. But if the service connects 200m people, everybody wants to be in on it.

Yet the defenders of the protected status quo would do well to examine what has been happening in other networked industries. In telecoms, which was deregulated later but much more thoroughly than airlines, large network operators have to give independent carriers access to their networks for a fee. Electric utilities, too, now have to allow access to independent suppliers in many countries. And in the days when America had a proper passenger rail service, the stations were shared by several rail companies.

Mr Hudson does not see why this principle should not be applied to airlines. For instance, code-sharing amounts to two airlines selling the same sorts of seats on a flight. If the flight were regarded as part of a network, why should the reservation systems, and thus the seats, not be opened up to independent third parties to sell? After all, code-sharing and block-booking is already bringing competition into the cabin, in the sense that two airlines might quote different prices for a given seat on the same flight. But the competition is limited to only two companies. Why not many more? The instant access to information that comes with the Internet might drive the business in this direction anyway, whether the airlines like it or not.

There are also more down-to-earth ways in which access to the airline networks could be improved, if only the will were there. Part of the problem is that most American airports are owned by local authorities, which are more interested in maximising short-term revenue than in promoting competition. In fact, this is against their long-term interest, because the more competitive an airport is and the more new users it can attract, the more it can grow and so stimulate the city's economy.

But the main block to progress is the commercial relationship between the airlines and the local authorities. Everybody in the industry agrees that America's infrastructure has not kept pace with the growth of air travel, and that it will not be able to handle the doubling in traffic expected over the next ten years. What is less well understood is the role of the airlines in blocking expansion that would create more capacity and let in competing airlines. They are given a say as "major investors" in decisions affecting an airport's future because they underwrite investment in developing gates and facilities.

Mr Hudson points out that American Airlines and United, which dominate Chicago O'Hare, have consistently blocked proposals to build a third airport in the area to supplement O'Hare and the smaller Midway airport. The local authorities often collude with such obstruction because they want to keep in with the airlines. They also welcome the burgeoning retail parks that America is learning to build at big airports, copying an idea successfully pioneered by London's Heathrow. Similarly, expansion of Hobby Airport in Houston was blocked by Houston International. The only big new airport to be built in America in the past ten years was Denver International, and even there the old airport was razed for a housing project in order to eliminate the competition.

Even more damaging, in the eyes of the consumer lobby, is the relationship between airlines and airports over gate concessions. Municipal airports grant long and exclusive leases of up to 30 years to airlines prepared to sign up and guarantee an income stream, enabling the local authority to issue bonds to

cover its investment. But the airlines are not obliged to allow independent airlines to rent the gates, which often makes it difficult for the independents to run services where the demand is—at big airports. “These are monopoly contracts,” says Mr Hudson. “They are allowable only because the airports are local-government entities. A private company could not get away with it.”

The weaknesses of America’s aviation system, then, lie in a protected market, incomplete deregulation and over-reliance on the public sector for the provision of infrastructure. There is one other big problem: air-traffic control, which causes huge trouble in Europe as well as in America. But here some progress is being made, and a solution may be just over the horizon.

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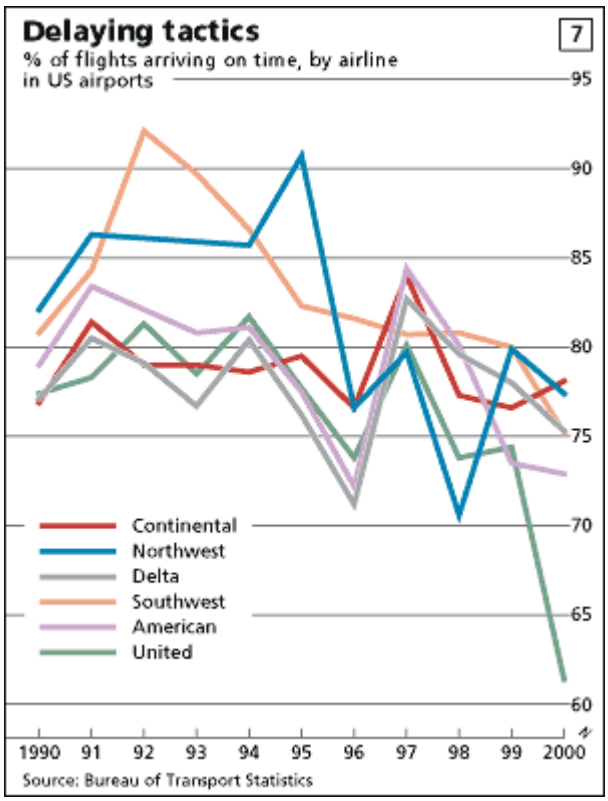
Free as a bird

Mar 8th 2001
From The Economist print edition

New technologies that allow aircraft to control their own flight could solve the problems of crowded skies



"IMAGINE driving your car with the windshield covered and someone telling you what turns to make," says Phil Condit, chairman and chief executive of Boeing, the world's biggest aircraft maker. "That is the present air-traffic-control system. An alternative would be a clear windshield and ability to see traffic along a highway for pilots." He is sketching the possibilities of a satellite-based system that could take over from conventional air-traffic control, allowing twice the number of aircraft flying in most parts of the sky at any one time. The system is known as "free flight". Boeing is so excited about the potential $70 billion-a-year market that it is setting up a new company to provide systems for this revolutionary form of air-traffic control.

Pilots have long dreamt of flying exactly where they want. At present they are controlled by a ground-based system that obliges them to stick rigidly to prescribed routes, often not the shortest ones, dictated by the need to stay close to radio beacons or radar stations. Under the new system they would be able to choose their own route and file a flight plan that follows the most efficient and economical path. Conventional air-traffic control, which relies on radar and wireless communications, has severe limits in today's crowded skies. Radar is accurate to only a few miles, and involves exchanging much routine information between the pilot and the controller over the airwaves.

Pinpoint precision

Modern satellites and digital technology offer a way round this. Thousands of aircraft are already fitted with global-positioning-system (GPS) navigation aids. These are based on the American Defence Department's satellite network, which is capable of pinpointing an aircraft's position to within a few metres. Under conventional air-traffic-control systems, aircraft have to stay five miles apart at the same level or be separated vertically by at least 1,000 feet. Obviously, if the more precise technology now available were brought into general use, more aircraft could be packed into a given area of sky,

increasing the system's capacity.

Air traffic in America and Europe is expected to double by 2015, so something needs to be done. In America air-traffic delays already run at around 50,000 a month (one flight in four) during the peak summer season, and in Europe things are worse: one flight in three is more than 15 minutes late, mainly because of hold-ups by air-traffic control. Most people reckon that the skies are already overcrowded. With few new airports and runways being built outside Asia, attention is turning to how the present capacity can be managed more effectively.

Both America's Federal Aviation Administration and Eurocontrol, the Brussels-based body that co-ordinates European air traffic, are working on a phased introduction of free flight as a way of handling more flights without more runways and airports. The FAA is careful to point out that free flight is not a free-for-all at 35,000 feet, but a way of minimising air-traffic restrictions to speed things up. No one expects it to replace air-traffic control on the ground. But much of the ground controller's job will pass to the pilot, and more of the communication between the two will be by automated digital data flow. The ground controller will monitor what is going on and be ready to intervene when something is going wrong and the pilot needs to be alerted to a danger.

Europe's air-traffic-control system suffers from having 31 national sub-systems, which means that a lot of air time is spent handing over from one to another. For the immediate future, the Europeans are trying to break down such barriers as a way of enabling the system to handle more traffic. But beyond 2005, Eurocontrol has plans for introducing "autonomous separation", a limited form of free flight, which the organisation thinks could add as much as 40% to airspace capacity, by having aircraft flying closer together without jeopardising safety. Beyond 2010, it plans for more extensive free flight to yield a further 40% improvement.

The FAA, too, has a two-phase plan for introducing free flight. The first, due for completion in 2002, is to open the air-traffic system to collective decision-making, giving airlines access to up-to-the-minute status reports so that they can choose how to deploy their aircraft. Another objective is to set up a "conflict probe" system that looks 20 miles ahead of an aircraft and tells the controller on the ground when he should intervene with a free-flying pilot to avoid a collision. Two free-flight trials already under way are the National Route Programme and the Central Pacific Oceanic Programme. The first allows aircraft flying above certain predetermined altitudes to choose their own flight paths. The FAA puts the savings from this at over $40m a year, because aircraft are able to take a more direct route, burn less fuel and reach their destinations more quickly.

Don't come near me

Safety is built into free flight by having two airspace zones around an aircraft. The size of the first one, known as the protected zone, depends on the aircraft's size and speed, and the sophistication of its communications, navigation and surveillance equipment. The protected zone must never touch the protected zone of another aircraft. The second zone, known as the alert zone, is much bigger. Two aircraft can manoeuvre freely until their alert zones touch. When that happens, a ground controller contacts the pilots and helps them decide how to maintain safe separation, or supervises them while they do it themselves. To begin with, this may still be done over the radio, but gradually more and more of it will be done through data links from the ground that will automatically tell the pilot when something needs to be done.

Not everybody is impressed. "It's all very well organising the flow of traffic in the air better," says Jeff Campbell of American Airlines. "The real problem is at the airports where traffic joins or leaves the system." Yet Boeing is convinced that its new air-traffic-management business holds the answers to many of the problems of the crowded skies. Picking his words carefully, John Hayhurst, the boss of Boeing's new business unit, explains that the technology for this four-dimensional satellite control already exists, "although developed for different purposes".

What he means is that military systems have long been able to plot and even control the flight of offensive as well as friendly missiles. "When you read about missiles fired defensively to hit offensive missiles before they hit their target, it is obvious that the technology to know where both are at one time is there. We can know where airborne objects are at any one time and where they will be." The obvious example is the destruction by American Patriot missiles of some Iraqi Scud missiles during the Gulf war ten years ago. "The idea of making the technology work does not keep me awake at night," says Mr Hayhurst. "The real challenge is getting diverse interests focused on implementing a solution quickly."

Mr Hayhurst is not advocating a system where pilots fly where they like, relying on their knowledge of each other's position and direction to avoid collisions. That might work on the road, though the risk of a fatal accident per mile of road travel is over 100 times higher than in the air. But aircraft go about ten times faster than cars on motorways, and when they collide, the deaths are counted in hundreds.

The only real technical problem to be overcome before free flight allows aircraft to bunch closer together is that of the vortex of turbulence created by each aircraft. This is a particular danger for smaller aircraft following large ones. They could be thrown around so much by the swirling air currents behind something the size of a jumbo that they might crash. This "wake vortex" must be eliminated, or at least reduced, before closely spaced landings and take-offs become possible.

Boeing says it is working on several ways of doing this, including adding on little winglets at the end of aircraft wings, using jets of steam puffed out of the wing ends, and fitting attachments to various parts of the wings so that the vortex from one is used to cancel out that from the other. Whatever the method, the experts seem confident that the problem can be solved now that free flight has come within reach.

As the technology evolves, the business of air-traffic control is itself moving away from being a government responsibility and becoming more commercial. Canada, Australia and New Zealand have already set up commercially oriented air-traffic-control agencies, and Germany is moving the same way. Britain is intent on selling half the shares in its air-traffic-control system to the private sector, perhaps to a group of airlines or another trade investor, but trade unions and left-wing politicians complain that the plan compromises safety for the sake of profit. The controversy has put Boeing off bidding in the British privatisation, but it says in principle it is interested in public-private partnerships and in being involved in whatever way seems appropriate. Boeing's detailed plans for its free-flight system will be unveiled later this month. Other companies, such as Honeywell, are also well advanced with their own versions. With capacity constraints now adding to the political pressure for modernisation, and privatisation promising to unlock the necessary funds, it looks as though air-traffic-control problems at last have a chance of being resolved.

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Webbed wings

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From The Economist print edition

How the Internet is transforming air travel

ONE sunny afternoon last January, Continental flight 124 from Seattle to Newark was put on hold for up to five hours because of snowstorms on the east coast. The passengers disembarked and milled around the lounge, wondering what to do next. Older travellers queued to bombard harassed ground staff with questions. Not so the cool youngsters returning to college from skiing trips over the Canadian border. They were whipping out their little Palm Pilots and logging on to the web to find out if there was any other way they could get to their destination. The Internet has already made a big difference to aviation, and portable computers in particular are becoming part of the machinery of booking and buying air travel.

AP

Bethune's wired

With the benefit of hindsight, that should have been no surprise. The Internet and aviation were made for each other: flights are a high-value, perishable commodity on which up-to-date information can be made available electronically. The buyer is hungry for such information so he can get the best deal. The airlines, for their part, depend for their profits on what they call yield-management systems, which are highly sophisticated computer models for altering the price of seats on a given flight to reflect the demand over time. This is the system that doles out cheap tickets to early bookers and ensures that last-minute travellers needing flexible tickets pay much more for the privilege. In the mainstream airlines in America the dearest ticket can cost up to 20 times as much as the cheapest on the same flight. Even with low-fare, no-frills carriers such as Southwest, the dearest fare will be twice the cheapest on any given flight. So the Internet offers advantages to both buyer and seller, because it can cope with a rapidly changing market.

The airlines have a further motive for embracing the web: it offers them huge savings on their marketing and distribution costs, which make up about a quarter of their total operating expenses. For a start, it saves them commissions of up to 5% on ticket sales. It also eliminates the cost of printing and sending out tickets and the fees (around $11 per ticket) for the computerised reservation services that are the lifeblood of today's distribution.

Cutting out the cumbersome process of issuing cardboard tickets and simplifying booking and check-in can also be attractive to customers. Some airlines, such as Northwest and Swissair, already offer online facilities for seat selection and checking in, as well as for booking and paying for flights. Online ticketing was put on ice for a while in 1999 because airlines were worried about the effect of the millennium bug on their computer networks, but quickly resumed after the magic date.

No wonder that travel sales on the web are already bigger than books, clothes, software, toys and sports goods put together. Air travel accounted for about $5 billion of the total of $7 billion spent on travel on the Internet in 1999, according to a marketing-strategy company called PhoCusWright. It estimates that by the end of this year ticket sales will be at nearly three times that level. And even in America, as yet only 4% of flight reservations are made online; in Europe, the figure is barely 1%.

Just looking

For the moment, it seems that air travellers are still using the Internet mainly to browse for information before booking flights by more traditional means. Travelocity (owned by Sabre, a computer reservations system which is a subsidiary of American Airlines' parent company, AMR) said that by last summer its 20m registered members had bought only 6m tickets, which is not a commercial proposition. Sabre is having to trim jobs to cut costs.

Some airline bosses, such as Gordon Bethune of Continental, think the Internet will soon account for the majority of bookings. It already does at low-cost carriers such as Southwest, EasyJet and Ryanair, where up to 90% of tickets are bought online, helped by the fact that these airlines are selling simple point-to-point flights rather than complicated itineraries. But conservatives such as Thierry Antinori, in charge of sales at Lufthansa, think that although the share of Internet bookings will rise steadily, it will not go beyond a third of the total.

The Internet has also thrown up a host of online agencies such as priceline.com and hotwire.com which are essentially electronic versions of the traditional "bucket shops", agencies that buy blocks of spare seats from airlines and sell them through small ads in the newspapers. Priceline is an independent company, whereas Hotwire is partly owned by six American airlines (American, United, Northwest, Continental, US Airways and America West, along with Texas Pacific, an investment company that is the majority shareholder). Like the bucket shops, these agencies are useful for the airlines because they enable them to offload empty seats at low prices without being seen to compromise their normal fares. If they own the agency, as with Travelocity or Hotwire, they can also keep control of the prices at which seats are sold.

Yet another agency is due to start trading this summer. Called Orbitz, it is owned by American, United, Continental, Delta and Northwest, and is altogether more ambitious than its rivals. It uses a hugely powerful search engine, designed by ITA Software, a start-up company formed by scientists at Massachusetts Institute of Technology, which can process half a billion combinations within seconds to offer the traveller a large choice of flights. It will also have access to all the airlines' Internet-only special fare deals, which at present can be found only on their own websites.

But it will not have the market to itself. Expedia, owned by Microsoft and the Worldspan global distribution system, has also signed up to use ITA technology, setting the scene for a titanic clash between the two. These online agencies might eventually beat off any collective challenge from the airlines to take them on with agencies such as Orbitz or its European equivalent, T3. However, it is worth noting that in other industries the big, established companies, after a lag, have tended to move into e-commerce and resume their dominant position.

E-commerce will also allow airlines to get much closer to their web-using customers, learning more about them so they can package offers tailored to their individual needs. This is what marketing people call "customer of one", and it applies to airlines just as it does to motor cars or computers.

Stephen Brobst, chief technical officer at Teradata Solutions, part of NCR, is an expert in databases and large systems who has worked on many of the huge computerised reservations systems that the airlines started to assemble from the mid-1960s onwards. In those days such reservation systems were at the cutting edge of computer applications. He distinguishes between different levels of airline websites. The most basic are today's "brochure sites", which simply offer static information. The next step is to have constantly updated versions of the same. Things get a little more interesting with the third generation, which can obtain information from the customer as he logs on and build up a profile of his travel needs and preferences. It can answer requests for information, take bookings and issue e-mail confirmations of bookings. This sort of e-commerce transaction is now quite common, especially for no-frills airlines.

The next-generation website will recognise John Smith when he logs on and know that he is a valuable customer from another airline. It will analyse his travel history, perhaps suggesting alternative itineraries that might suit him better. Funnily enough, though, whereas multi-airline sites such as Orbitz or non-airline ones such as Expedia make fares more transparent, sophisticated airline sites with their capacity to treat each customer as an individual add yet another layer of obscurity.

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Flight of fancy

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Look on the bright side

THE date is March 9th 2016. Jose-Luis Romero, sales chief of a small textile company, based in eastern Los Angeles, is thinking about his business trip next week. He wants to go to New York, then on to London, Frankfurt, Singapore and Hong Kong. Any one of the three new multinational airlines formed when barriers to foreign ownership were lifted will take him to those cities. Their frequent-flier schemes, however fancy, will not influence his choice because he is a member of all of them. So should he fly Lufthansa United, American-British or Delta French?

All three have subsidiaries with totally integrated networks operating around the world. Money is as tight as ever in textiles, so his company encourages its managers to cut the best possible fare deal. Since the global oligopoly emerged, the published fares of the three mega-airlines have been much the same; the trick is to find out which of them have overcapacity on what flights, and are selling cheap seats on the Internet. As he gets out his personal communicator (as mobile telephones are now called), he decides to give the airlines' websites a miss. They had already e-mailed him their best offers the night before when they noticed him browsing. Instead he goes to one of the multi-airline sites, which can trawl instantly through millions of flights to display the best choices. He comes up with two attractive options.

He is torn between Delta French, with its double-deck Airbus A380, complete with gym and casino, and American British, with its futuristic new Boeing BWB. This is the most revolutionary civil aircraft ever seen, a kind of flying wing. Instead of sitting in a big fat tube, as in a conventional wide-bodied airliner, he would take his place in an amphitheatre with anything from 250 to 650 seats, with wraparound cinema screens; a great way to fly if you want a big entertainment experience. It reminds Mr Romero of his father telling him about the days when PanAm had a piano bar in the upstairs lounge of its early jumbo jets—until the airline realised pianos did not buy tickets.

In the end he decides to fly Lufthansa United, with its traditional Boeing 747 Super Xs, conventional aircraft but with a much quieter, smoother ride than earlier jumbos. He taps his reservation into the website and is given his confirmation number and seat reservation. A week later, at the airport, he simply waves his mobile phone at a sensor, gets his bag screened as he walks past security, and within minutes has arrived at the upper-deck boarding gate, without having had to queue once or talk to any member of the airline staff. It seems unthinkable that not so long ago you used to have to show those ridiculous old cardboard boarding passes every ten yards on your way to the aircraft.

The airline world is not quite ready for Mr Romero's trip, but it is getting there. Thanks to Internet access by wireless telephone, the business of booking and checking in over the web can already be married to the portable device, which can hold electronic information needed for boarding the flight. The other innovations that could speed Mr Romero on his way may or may not happen, depending on whether the airlines think they are worth developing.

There is no doubt that the most tangible change around in aviation now is the effect of the Internet on sales and distribution. This is not simply another way of delivering the product. The information-seeking power of the web will, for the first time, provide consumers with their own weapon to wield against the airlines' yield-management systems. "Airline fares have always been a confusing mass of smoke and mirrors," says Mr McMullan of Aviation Economics. "The Internet will blow away those elements of obscure fare pricing."

This could also have wider repercussions; for example, it could affect the way the proposed mergers in America will operate. The apparently overweening power of three national airline networks could be mitigated to some extent by the transparency in fares that online agencies can bring, especially if some of them are outside the control of the airlines. But even the airlines themselves, by participating in joint sites, are opening the door on the secret world of fares and deals. The web-armed consumer will be much more aware of the burgeoning point-to-point services of low-cost carriers as well as the larger networks of the mainstream airlines. As the barriers to international mergers start to crumble and mega-carriers begin to form, this will start to apply not only to America but worldwide.

The other changes, and pressures for change, outlined in this survey are more closely linked to each other than they appear at first sight. One of the biggest obstacles to change is the extraordinary hold the trade unions have over American airlines. Mr Crandall, a famously grumpy, hardline boss when he was at American Airlines, used to comment ruefully that pilots have a squadron mentality: more loyalty to each other than to their employer. He was uncomfortably aware that a determined bunch of pilots out for a pay increase could bankrupt an airline in six weeks. It was that power which persuaded United last summer to give in to its pilots. Having tried at first to resist them, it awarded them a 40% rise over several years. Now cabin attendants, mechanics and other groups of employees are pressing for similar rises. A hand-baggage tag sported by a United cabin attendant reporting for a recent flight from Washington, DC, said it all: “Pay us or chaos”, it read.

Now it looks as though Continental and Southwest are the only two American carriers where the management and labour force are not at war. It is not a coincidence that these are also the only two whose earnings are holding up. As for the rest of the industry, the employees are not being quite as rapacious as they might seem. They remember how they put up with poor pay and conditions to help the struggling carriers in the early 1990s. Now, after a few years of good profits, they think it is pay-back time. The employers, for their part, point to the need to stay lean and mean in a highly competitive market. With mergers looming, fear of job losses further sours the atmosphere. There is every chance that this will be an awful year for disruption triggered by labour disputes. President Bush could find himself mired in aviation troubles before the end of his first year in office.

Wheels within wheels

But there is a wider significance to the unions’ power. It is the main reason for America’s refusal to allow foreigners to operate services or own local airlines. The unions object to these things, and the politicians do not want to upset them. That is why Rodney Slater, transportation secretary under President Clinton, used to say that cabotage or ownership rights were “just not on the agenda”. So Britain refuses to allow more American airlines into Heathrow airport, which America considers a precondition for any open-skies agreement. That ten-year stand-off is now holding up a wider free-trade deal, the transatlantic common aviation area; and without that, there can be no widespread relaxation of ownership rules. So airlines are stuck with alliances instead of the mergers or takeovers they would prefer. That, in turn, holds back innovation in the airline business, because alliances are full of committees and, as Mr Eddington at BA points out, there is no single management to drive things forward.

If those two pending mergers in America are allowed through, the trade stand-off might move closer to a resolution. The resulting groups would feel more capable of withstanding any foreign competition they might encounter. In reality, such competition may turn out less daunting than feared, because the big American airlines tend to be more efficient than the European ones. It seems, therefore, that the Americans are blocking progress in an area that is important to them for what may not be very good reasons. It may turn out that foreign competition will do little harm to either American airlines or airline jobs. As soon as the Americans begin to understand this, reform will start to look possible, and aviation will begin to join the globalised world it has done so much to create.

In addition to those quoted in the text, the author would also like to thank the many other people who helped with the preparation of this survey.

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Offer to readers

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Gadget wars

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A new breed of consumer-electronics device is emerging from the computer industry, and with it a new sort of consumer-electronics company

SINCE its creation with the videocassette recorder 25 years ago, the modern consumer-electronics industry has changed surprisingly little. Apart from the personal computer (PC) and mobile telephone, which have both become industries in their own right, five new product categories have achieved mass acceptance: the video recorder, videogame consoles, CD players, answering machines and cordless phones. During that time, however, the main companies making consumer electronics have remained broadly the same. The list is still dominated by the Japanese firms, such as Sony and Matsushita (Panasonic), that have led for decades.

This tidy arrangement is in for a jolt. Over the past few years, a host of new digital gadgets with mass-market potential has arrived. These gizmos are both radically different from their predecessors and often made by firms outside the usual consumer-electronics world. Many are devices spun from the computer industry, such as personal digital assistants (PDAs, such as the Palm) and recordable CD players. Others, such as digital cameras and DVD drives, have their roots in consumer electronics but have nevertheless been adopted by PC users first.

Joining them are dozens of similar devices—such as portable MP3 players, “personal video recorders” (PVRs, such as the TiVo), interactive pagers and Internet radios—that, although aimed at smaller audiences, are no less a departure from the usual consumer-electronics fare. And later this year, Microsoft will take aim at one of Japan’s longest-lasting consumer-electronics strongholds when it releases its XBox videogame console, based on the guts of a PC.

This fabled “convergence” of the analogue consumer-electronics world with the digital world of computing has been a long time coming. But unlike the simple substitution of, say, a digital camcorder for an analogue one, the new products have fundamentally different DNA from their predecessors. The new wave of digital devices not only use PC technology and are marketed as PC peripherals, but are often made by companies that have their roots in the PC industry itself.

A few years ago, a typical gadget-hound might buy his camera from Olympus, his Walkman from Sony, his video recorder from Panasonic, his handheld organiser from Sharp, and his game console from Nintendo. Now his digital camera is just as likely to come from Hewlett-Packard, his MP3 player from Sonicblue, his organiser from Palm and his next game console from Microsoft. The list of surprising new consumer-electronics firms goes on and on: Dell, Compaq and Gateway are all selling their own MP3-playing stereo boxes; 3Com makes a tabletop Internet radio; Intel sells digital cameras, portable audio players and even digital microscopes for children.

Although the PC itself is nearly as old as the video recorder, the rise of its consumer-electronics offshoots is a reflection of its maturity. As it has penetrated a mass market, and as broadband connections to the home have spread, the PC has become an entertainment hub and the heart of the digital life, with the

gadgets to match.

The fact that consumers think of digital cameras, MP3 players and the like as PC accessories not only influences how they use them, but also which firms they buy them from. With few exceptions, consumer-electronics firms have stumbled when they have ventured into PC territory, in part because the notion of building products that depend so much on technology from Microsoft and Intel runs counter to their culture. For all its market might, Sony tried for years to crack the PC market, failing with several undistinguished desktop and laptop lines before designing its hit Vaio notebook with the help of former marketers from Apple Computer. NEC has suffered from both its own failures and its catastrophic acquisition of Packard Bell, once a PC leader.

The struggles of the consumer-electronics giants to bridge the divide have created an opportunity for the Dells, Compaqs and Gateways of the world to use their own computing strengths to push the other way. Their new digital devices are not evolutions of existing products; they are something completely new. Consumers come to them without preconceptions.

Buyers do not think of an Internet radio, for instance, as just another sort of radio, but rather as the sophisticated piece of networking and computing equipment that it is: for that, they may well trust 3Com far more than Aiwa. Likewise for a portable MP3 player. Any fans of Sony's Walkman who try the digital version will be sorely disappointed. Because Sony is also a music publisher, it has saddled its MP3 players with fiendishly complicated anti-piracy software that makes them hard to use. These are signs of a consumer-electronics firm that does not fully understand the culture of computing. It is notable that when Sony released its own PDA and PVR, it had to base them on technology licensed from Palm and TiVo, a rare display of weakness from a company that has long tried to push its own standards.

Although digital technology has created a great opportunity for consumer-electronics outsiders, they would not succeed without another, parallel trend. Once, to be a big consumer-electronics firm meant building and operating huge factories in low-cost parts of the world. Now this work is increasingly outsourced to contract manufacturers, such as Flextronics and Solectron (which recently bought two factories from Sony). These companies will work for anyone, allowing even the smallest start-up to manufacture devices on the same production line as, say, Panasonic. New-age consumer-electronics firms, such as Palm and Handspring, do not have a single factory between them, despite shipping tens of millions of devices.The rise of the contract manufacturer has lowered the barrier to entry into the business dramatically.

This time it's different, isn't it?

So new companies can increasingly challenge the huge incumbents. But should they? After all, most American firms left the business in the 1970s not because they could not innovate but because their shareholders could not stomach the poor earnings. Consumer-electronics devices are among the fastest to commoditise, as Asian firms quickly copy technology and drive prices down. The success of the Japanese can be partly explained by a capital structure that has allowed them to survive with little profit.

But here, too, digital may turn out to be different. As with the PC itself, most of the value turns out to be not in hardware but in software and related services. Palm's strategy is eventually to make most of its money from licensing its technology, selling content and software to be used on its devices, and providing services such as wireless Internet access. Microsoft expects to lose money on its XBox hardware, but make it back with services such as online multiplayer game networks. TiVo already makes most of its money from subscription fees.

Does all this spell the end of Japan's domination of the consumer-electronics industry? Not quite. For a start, the new digital devices account for fewer than 10% of consumer-electronics sales in America; the overall market share of Japanese firms in the United States has hardly budged over the past decade. Indeed, a more superficial digital shift—the transition from video recorders to DVD and from analogue camcorders to digital ones—will provide huge windfalls over the next few years for the Japanese firms that dominate both markets.

Secondly, Japanese firms may have been far slower than their PC cousins to introduce digital innovations, but at least they know it: most now have Silicon Valley research laboratories, and all talk a good digital game. They are still huge conglomerates, torn by inter-divisional rivalries and constitutionally conservative. But for hybrid products with their roots in both analogue and digital camps, their evolutionary approach has proved good enough to protect market share: with a few exceptions, the

leaders in digital cameras are the same Japanese firms that dominate film cameras.

Nor is it clear that the shift towards products from the mostly American computer industry is permanent. So far, most of the new digital devices have gone to gadget fiends and knowledgeable PC users, who are comfortable with brands from the computer industry. But as the products spread to the mass market, they will meet consumers who expect gadgets to be, above all, easy to use, and who may even think of an Internet radio as, well, a radio. This is the stronghold of the established consumer-electronics giants, with their trusted brands and their huge retail channels. It is their market to lose. But it is no longer their market alone.

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Coca-Cola

A cultural revolution

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"LET a hundred flowers blossom, and let a hundred schools of thought contend." Douglas Daft, Coca-Cola's chairman—and formerly its man in Asia, where he built his reputation—seems to have taken one of Mao Zedong's favourite sayings to heart in his attempts to shake up the Atlanta-based soft-drinks giant. The company has started to emphasise a whole stable of brands alongside traditional Coca-Cola, some of which—God forbid!—are not even fizzy. Local managers, and even humble bottlers, have been encouraged to contribute ideas and assume more responsibility. There has even been progress on increasing diversity among its staff, an issue that had long dogged Coke and led to a lawsuit from black employees last year. For the first time in years, Coke's people have been encouraged to debate the future of their company.

But too much debate, as Chairman Mao realised, can be bad for the revolution. On March 4th, Coke announced that Jack Stahl, its highly respected president and chief operating officer, was resigning as part of a reorganisation of top management. Mr Daft argues that its new structure, which cuts six divisions down to three geographical fiefdoms and a New Business Ventures unit, received Mr Stahl's blessing, even though it made his job superfluous. But after months of speculation about strategic differences between Mr Daft and his number two—Mr Daft hints at tussles over Mr Stahl's relative slowness in making decisions—that seems a little too convenient.

This impression is reinforced by Coke's recent history. Mr Daft's predecessor, Douglas Ivester, refused to appoint a chief operating officer and had Coke's regional barons report directly to him. His autocratic manner irked fellow directors, however, and it was notable that one of Mr Daft's first acts as boss was to elevate Mr Stahl, previously head of the group's American operations and its Minute Maid juice company. Now, Mr Daft has ditched the idea of having a second-in-command again, in the name of cutting a layer of bureaucracy.

If this means that Mr Daft, a consensus-seeker by nature, is toughening up, that may be no bad thing. His control of the company certainly looked shaky late last year after the board overruled his attempt to buy Quaker Oats, which makes the Gatorade sports drink. Following two years of lower-than-expected growth, Coke needs firm leadership to push through changes in strategy. But Mr Daft must walk a tightrope: neither Coke's employees nor its suppliers will welcome a return to the command-and-control structure, centred on Atlanta, that characterised the last regime.

Beyond that, Mr Daft continues to face tough market conditions. He has fought back by launching new initiatives. Since the beginning of this year, he has created a new company with Nestlé to chase market share in ready-to-drink tea and coffee; announced an exclusive global marketing partnership with Warner Bros for the eagerly awaited Harry Potter film; formed a $4 billion joint venture with Procter & Gamble (P&G) to market juices and snacks; and signed a deal with Walt Disney to brand Coke's Minute Maid drinks with Disney characters.

Much of this is the kind of innovative marketing that Coke needs more of, even though Wall Street gave the thumbs down to the agreement with P&G on the ground that the brands contributed by the household-products giant, such as Pringles crisps, are slow-growing. But the real problem is that all this is just tinkering. The vast majority of Coke's sales and profits continue to come from fizzy soft drinks, where volume growth remains well below the group's 7-8% long-term target. Mr Daft will be judged on his ability to get this core business ("our life and our money") moving again. His Long March is only just beginning.

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Enterprise software

Analyse this

Mar 8th 2001 | AMSTERDAM
From The Economist print edition

IN THE days when all shopping was local, shopkeepers would often hand over a customer's goods before being asked to, because they knew what each person routinely wanted and had prepared the order in advance. Such precision remains the envy of modern companies competing to attract new customers and retain existing ones. For banks, utilities and other mass-market industries, the goal of truly personal (and profitable) service has proved largely elusive. Now, however, a new generation of high-tech firms thinks it has found a solution.

In recent years, software companies have developed systems to automate customer relationship management (CRM), as it is known, and thereby to help marketing, sales and service teams to operate more efficiently. The market for CRM software is dominated by Siebel Systems, a fast-growing American company that is as powerful in its own sector as, say, Oracle is in databases.

The CRM market has so far proved more immune to dotcom fall-out than other bits of the software business (although Siebel's shares fell by 14% on March 6th, on news that a top sales executive was defecting to Vignette, a Texan rival). Few established companies have felt they can afford to ignore this powerful new way of interacting with customers. European firms, for instance, spent some $423m (*euro*397m) on CRM software in 1999. That figure is expected to rise to $3.5 billion by 2004, according to the Gartner Group, a consultancy.

However, CRM has failed to live up to its promise. Take a typical large retail bank. It might spend two years installing a fancy CRM system in its call centre, at a cost of as much as $30m. The system can help the bank's operators to deal with customers more quickly so that more calls can be processed. And the marketing people can "mine" data for information about customers and use it to design new products. But that is about the extent of the benefits. The marketing team still relies mostly on feel. And because the bank also connects with its customers in branches, via cash machines, on the web and so on, the CRM system has limited power to view each customer's overall relationship. It is therefore unable to make insightful suggestions about what customers might be lured into buying.

New software means this could become an old problem. The trick, says Robert Baldock, chief executive of Data Distilleries, a privately owned Dutch company, is to analyse customer behaviour in advance, so that a personalised offer can be made with a good chance that it will be accepted. Old systems cannot do this because by the time they generate a sales idea it is too late: the customer has already rung off or walked away. Data Distilleries built its software around the assumption that there are normally only a few seconds during which customers can be assessed. If they possess the right attributes, then they can be offered a relevant product. Using algorithms, Data Distilleries' call-centre application can flash up a sales idea in less than two seconds, so operators have ample time to make a pitch that is precisely tailored to the client.

This approach to CRM can have significant advantages. Spaarbeleg, a savings and investment subsidiary of Aegon, a Dutch financial-services group, receives more than 2m calls each year at its call centre. Before it introduced Data Distilleries' software during 1999, its operators sold a new product roughly once every 4,000 calls. Today they average a remarkable rate of better than one sale for every two calls during which an offer is made. Spaarbeleg's direct-mail campaigns have also become more effective.

Data Distilleries does not have this lucrative bit of the CRM market to itself: rivals include Norkom, an Irish company, Quadstone, a British one, and America's E.piphany. But Data Distilleries has one big advantage: a strategic alliance with Accenture (previously Andersen Consulting), a global consulting group that also owns an equity stake and is busily putting its new partner in touch with senior managers in client companies. However good your technology, it pays to have friends in the right places.

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Face value

The man who would be cool

Mar 8th 2001
From The Economist print edition

In wooing Napster, Thomas Middelhoff, the boss of Europe's biggest media group, hopes to make money—but money isn't everything

Get article background

HE IS, he says, an "American who just happens to have a German passport." Even more than wanting to be seen as American in his approach to business, perhaps what Thomas Middelhoff, the boss of Bertelsmann, really yearns for is to be considered cool.

It is difficult to think of a better explanation for Mr Middelhoff's extraordinary decision last November to put money into Napster, the pariah of the recording industry. Although Bertelsmann, through its music subsidiary, BMG, in common with the four other big music companies, is still suing Napster for massive copyright abuse, Mr Middelhoff's conciliatory approach towards the online file-swapping pirate struck traditional record executives as a mixture of grandstanding and sell-out.

The sight of Mr Middelhoff at a press conference playfully patting Shawn Fanning, Napster's youthful founder, on the head, sharing the lad's bowl of "gummy bears" and asking for Napster T-shirts to give to his five children, was too much for some: BMG's two top managers quit a few days later. Vivendi's Jean-Marie Messier, an old friend of the Middelhoff family and recent acquirer of Universal, one of the Big Five music firms, could only shake his head in disbelief.

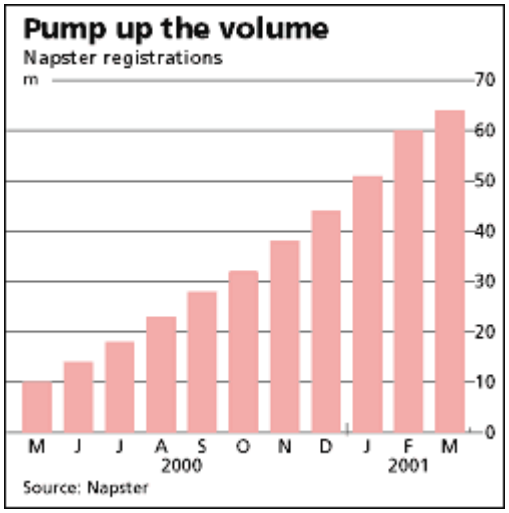
On March 6th, a federal judge gave Napster three days to filter out the copyrighted material of the big record labels once the firms issue a list of the tracks they want removed. But Mr Middelhoff appears unconcerned. Although the court's timetable is tough, he thinks the $60m his company has lent Napster should make it possible for Napster to comply ahead of launching a legal, subscription-based service in July. He thinks that the rest of the industry may also be coming round to his way of thinking: that working with a reformed Napster just might be smarter than shutting it down. Even Mr Messier said this week that he would consider licensing Universal's catalogue to a Napster that charged a subscription and passed money back to rights-holders.

But when Mr Middelhoff talks of Napster as being potentially the next America Online (a $50m investment in AOL made for Bertelsmann by Mr Middelhoff in 1994 was worth over $10 billion last year), it is time to pause. Mr Middelhoff sensibly argues that treating Napster's 60m-odd users as criminals is crazy. It should be possible, he says, to convert many of them into a legitimate, and profitable, fee-paying music community, a little like the book clubs that fuelled Bertelsmann's growth decades ago. If that happens, he can convert the loan to Napster into an equity stake, make another fortune for Bertelsmann and save the recording industry from its own short-sightedness.

But some big obstacles lie in the way. Although many Napsterphiles say in surveys that they are prepared to pay for their pleasure, there is a distinct possibility that the vast majority will simply switch to still-free clones, such as Aimster, that have made themselves much harder to shut down than Napster. Even if Napster does succeed in producing software that meets the record companies' requirements while retaining the pioneering "peer-to-peer" technology that lets users share music files on each other's PCs, the big labels may still be reluctant to enrich the entity that has brought them so much grief.

Mr Middelhoff is shrewd enough to know this. But by siding with

Napster's users in their demand for an easy-to-use and comprehensive online jukebox, he has been able to cast himself as a visionary, determined to shake up hidebound vested interests. In other words, someone who really "gets it". Someone cool.



Although he claims not to be interested in public relations, he also says that he wants Bertelsmann to be the most admired media company in the world. Certainly, the pace of change at Bertelsmann since he was elevated to the top job in late 1998 by the firm's patriarch, 79-year-old Reinhard Mohn, has been impressive. The acquisition of Random House by Mr Middelhoff, while still heir apparent, made Bertelsmann the biggest book publisher in the world. And if he can persuade competition authorities on both sides of the Atlantic to allow BMG to merge with Britain's EMI, Bertelsmann could soon also be number one in music as well. That is, however, quite a big if, given the ongoing investigation by the European Commission into overcharging for CDs.

The patriarch says yes

Mr Middelhoff has been just as busy shaking up privately owned Bertelsmann's ownership structure. Last month, he took a big step towards partially floating the firm by means of a share swap with Groupe Bruxelles Lambert, which left Bertelsmann with a 67% stake in RTL, Europe's biggest broadcaster. To the surprise of some, Mr Mohn, who has always prized the independence that has come with the company's close-knit shareholding structure, gave the deal his blessing. That was a big victory for Mr Middelhoff, who has become frustrated by the lack of an acquisition currency other than Bertelsmann's (plentiful) cash. Deals of the kind AOL did with Time Warner are not currently an option for Mr Middelhoff. For an honorary American, that rankles.

For the time being, Mr Middelhoff is pursuing the Americanisation—or "internationalisation", as he prefers to call it—of Bertelsmann in other, largely symbolic, ways. Increasingly, he spends time in the firm's office in Times Square rather than at its headquarters in the sleepy town of Gütersloh in northern Germany. Bertelsmen speculate that head office might even move to New York before long. Since 1999, English has been the firm's official language.

Mr Middelhoff also attaches great importance to the less formal dress code he has instigated. After a recent board meeting, not one of the departing executives could be seen wearing a tie. Mr Middelhoff himself is rarely photographed wearing a tie these days. It's just not cool.

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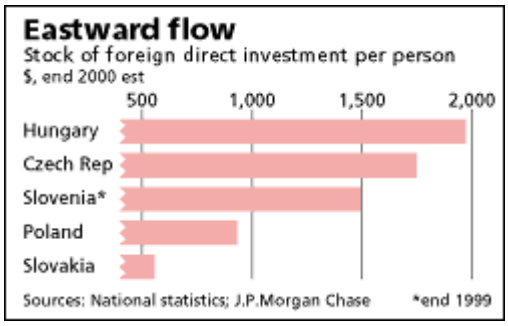
Czech industry

Poor planning

Mar 8th 2001 | PRAGUE
From The Economist print edition

WHO said the planned economy was a thing of the past in Central Europe? The Czech government is working on a scheme to spend 265 billion korunas ($7 billion) to revive the flagging economy. Around 40 billion korunas of this would go to some big unnamed companies in financial trouble. They employ many people, and Miroslav Gregr, the industry minister and the plan's architect, reckons they might stand a chance with a large dollop of aid.

Many of the firms are struggling to recover from a brutal two-year recession in 1997-99 that followed a currency crash. But their problems go back further, to a flawed programme of voucher privatisation in the early 1990s, which resulted in scattered ownership and a lack of corporate discipline. Straggling conglomerates ignored restructuring and became deeply indebted, abetted by soft lending by the big state-owned banks. In the end, so many companies could not pay their debts that the banks almost collapsed. The resulting credit crunch caused the recession and a sharp rise in unemployment, which is still three times the 1997 level.



Fortunately, the Czechs have learnt some lessons from that collapse. Most of the banks have been sold to foreigners, so companies can no longer struggle along on soft credit. Bankruptcy laws have been beefed up, too. Between 1989 and 1996, just three firms went bust. Since the currency crash, thousands have gone to the wall.

Others have been restructured over the past two years by the state "hospital bank", Konsolidacni Banka. Helped by western advisers, it has slimmed many state-owned firms and split them into sellable bits. Parts of Skoda Plzen, a troubled engineering group, were sold to western firms last year, while Germany's Siemens has been eyeing CKD, a tram-maker. Even Zetor, which makes tractors, looks likely to be sold soon. A symbol of communist pride, it returned to operating profit after being forced to build tractors only when it had received firm orders. These firms are recovering mainly because lack of cash forced them to restructure.

Mr Gregr's scheme may now hand them money and reverse that process. Many Czech companies are dead on their feet. He aims to get them walking. This is not his first attempt: he launched a similar scheme in 1999 to rescue more than 30 big, sickly firms. Lack of cash and protests from the European Commission meant that plan was watered down, and eventually covered just eight firms. A couple have since been sold, but most still languish in state hands. The betting in Prague is that these are the companies that Mr Gregr now wants to throw more money at, along with another 30 or so that long ago ceased paying their debts.

In fact, companies with potential do not need Mr Gregr's plan. Money is less of a problem than it was, because foreign investment has started flooding into the country. Until the currency collapse, the Czechs generally scorned foreign investment, preferring to keep big companies in local hands. Since then, a package of investment incentives and some big privatisations have brought foreign cash rolling in. Big investors include television makers such as Japan's Matsushita, Philips, a Dutch electrical group, and car-parts makers such as Germany's Bosch. These have been drawn to the Czech Republic by its clever, cheap workers and its proximity to the EU. Some $4.5 billion, or nearly 10% of GDP, flowed in last year. Another $8 billion will arrive if the government succeeds in selling a 64% stake in CEZ, the main electricity generator (though the process was held up this week by the threat of lawsuits from spurned financial advisers).

This foreign money is turning industry round. Foreign-owned firms now account for nearly half of Czech exports, and were responsible for almost all of the 17% surge in exports last year. And although total industrial production went up by a more modest 5%, it exploded in industries with heavy foreign

investment: transport production went up by 45%, for example, fuelled by the half-million cars built by Volkswagen-owned Skoda (no relation of Skoda Plzen).

Yet Mr Gregr wants to resuscitate the very bits of Czech industry that foreigners are avoiding. Why bother? He claims that “the market on its own cannot resolve the situation.” With the budget deficit running at 9% of GDP, though, he may yet be refused the cash to turn his grandiose vision into reality. Perhaps he will be forced to let the market do its work after all.

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Internet governance

Domain strain

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From The Economist print edition

A MONOPOLY can be a good thing—at least when it comes to Internet addresses. There has to be some sort of central governing body to ensure a unified system of domain names, as the strings of characters ending with .com or .net are called. Otherwise, the online world could soon fragment, with some websites inaccessible to some users. This is the raison d'être of the Internet Corporation for Assigned Names and Numbers (ICANN), the non-profit group that oversees the Internet's address system.

Yet for the first time, ICANN's monopoly faces a serious challenge. On March 5th, New.net, a start-up based in Pasadena, California, began selling domain names based on suffixes that are not sanctioned by ICANN. For an annual fee of $25, consumers and companies can register Internet addresses with 20 new suffixes (known as top-level domains), including .kids, .sport and .xxx. If ICANN bungles its response, the launch of this service could mark the beginning of the end of a unified cyberspace.

This is not the first attempt to create an alternative to the existing domain-name system. But the previous initiatives, which go by names such as AlterNIC, OpenNIC and Open Root Server Confederation, have failed to catch on with more than a small, politically conscious minority. This is mainly because they have not had the money or credibility to overcome a chicken-and-egg problem: to get Internet service providers (ISPs) to funnel traffic to their servers, they need a large number of users. But to acquire those users, they need ISPs to sign up.

New.net is the first challenger to ICANN with a chance of reaching critical mass. It is backed by Idealab!, a well-financed, though not always successful, dotcom incubator (one of its better-known hatchlings, eToys, filed for bankruptcy this week). More important, New.net has forged partnerships with leading American ISPs, such as Excite@Home and Earthlink, giving it 16m potential users from the start. And it has found a clever way to extend the official domain-name system. If web users want to have access to a site with a .com or .net address, their requests are handled by the existing infrastructure. If they type in a New.net address, the firm's technology automatically adds the extension "new.net", which routes the request to the firm's own name system.

None of this guarantees New.net's success. But if it takes off, there will be problems down the line. What if, for instance, ICANN wants to add top-level domains such as .kids, .travel or .game—all of which have been proposed to the organisation, but are now also in New.net's portfolio?

In some ways, ICANN has only itself to blame for this mess. It has dragged its feet in providing new domains, thus creating pent-up demand for memorable web addresses. It is mainly ICANN members with famous trademarks that have slowed the process, fearful that new domains would dilute their brands. On March 2nd, ICANN officials said that the introduction of seven new domains (.aero, .biz, .coop, .info, .name, .museum and .pro), which the organisation's board had picked last November, could be delayed for several months.

Might everything turn out all right in the end? The happiest result would be for ICANN to take the challenge from New.net as an opportunity to speed up the introduction of new domains by streamlining its cumbersome administrative procedures, so that a sufficient number of new suffixes can be added regularly and in an orderly fashion. There would then be less reason for competing services such as New.net to exist—and less danger of the Internet becoming infuriatingly balkanised.

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A dream car

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From The Economist print edition

IT IS a rare prospectus that begins with a quotation from Goethe: “Whatever you can do, or dream you can, begin it. Boldness has genius, power and magic in it.” But Amory Lovins, the venerable co-director of the Rocky Mountain Institute, a green think-tank, is not a normal entrepreneur. He thinks that the car industry’s incremental approach to cutting emissions will never amount to much. He intends to redesign the car from scratch.

A Revolution in the making

Mr Lovins has devised a concept car that he is sure will spark a revolution in the motor industry. For nearly a decade, a crack team of engineers has been beavering away in a hideout high in the Rocky Mountains. They have come up with the Hypercar, powered by a fuel-cell, zero-emission engine. This engine takes oxygen from the air and hydrogen from its tank to create a chemical reaction that produces electricity and water, the only by-product.

This alone would be unremarkable, given that all the world’s car makers are into fuel cells, if only because they have to meet zero-emission mandates in California. The difference with the Hypercar is that it takes a holistic approach. The entire body is made of composite plastics. The transmission and steering are entirely electronic, which removes the need for clunky mechanical parts. Instead of a steering column and wheel, there are games-machine joysticks, as in the cockpit of the latest Airbus jets—where a “fly-by-wire” system largely replaces heavy hydraulic and mechanical controls. The result is a big car with a fuel economy comparable to 100 miles per gallon (42.5 km per litre) of gasoline, almost twice what today’s most economical (diesel) cars can achieve.

Can this be serious? The technologies that Mr Lovins champions are not really far-fetched. Carbon composites, electronic controls and even fuel cells are feasible today. The reason that they have not been much used in cars is that established car makers have invested vast sums in conventional manufacturing technology. This has made them reluctant to embrace radical approaches.

Mr Lovins thinks he has come up with a business model that will swing the car giants behind him. One track of it is to put much of his technology in the public domain to spur established manufacturers to pick it up; the other is to keep to himself the most advanced bits, and to establish Hypercar as a niche, low-cost manufacturer. He is off to a good start: the Hypercar has so far cost only $2m to develop, around a tenth of what it would cost a traditional car company to get this far.

Although Mr Lovins is cagey, he admits that he has backing from big car-parts manufacturers, technology giants (including Sun Microsystems) and others. His strategy involves demand-led lean production of the kind pioneered by Dell Computer; he claims he needs to sell only 20,000 of a given model—such as the Revolution—to make a profit, because his production method will do away with expensive capital equipment. It may not be long before Mr Lovins finds out whether his airy concept car will really take off: he is currently passing the hat around, hoping to raise around $50m in additional financing.

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Not quite another eBay

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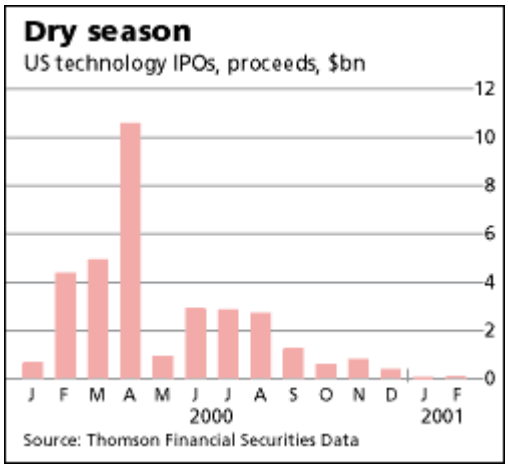
From The Economist print edition

WHEN eBay, the king of online auction houses, went public in September 1998, Wall Street held its breath. It was the first high-profile initial public offering (IPO) since Russia's financial crisis had triggered a mini-crash and made new stockmarket listings all but impossible. On the first day of trading, eBay's stock soared to three times the offer price—setting the stage for the dotcom IPO frenzy that abated only last spring.

This week there was a strong sense of déjà vu, as investors ran the rule over another bellwether IPO after a drought of offerings (see chart). Loudcloud, a Silicon Valley start-up co-founded by Marc Andreessen, of Netscape fame, was expected to sell shares worth up to $200m on March 8th. But even if Loudcloud's debut is a huge success (its shares had yet to start trading as *The Economist* went to press), nobody is expecting it to do for the high-tech market quite what eBay managed.

To be fair, Loudcloud is not your average dotcom—even though, at first sight, the firm looks much like other Internet start-ups, and is yet to make a profit (it booked a loss of $108m for the first nine months of 2000). To begin with, Loudcloud has Mr Andreessen, whose first company, Netscape, ignited the inaugural boom of Internet IPOs in 1995. The company also has an interesting business plan. Loudcloud is trying to carve a niche as a "managed service provider", or MSP. The firm, founded in September 1999, has spent much money to develop technology that helps it to automate the building of complicated websites for its customers and to ensure that those sites are secure and run well. So far, more than 40 firms have signed up, including AOL, Ford and Nike.



Assembling the pieces needed to build a large e-commerce system—equipment, network connections and so on—could become an attractive business. There are good reasons for companies to outsource this activity: technology is getting ever fiddlier, while IT talent is getting ever more scarce, relative to demand. It is no surprise, then, that Loudcloud does not have the field to itself. Several other firms, including Exodus and IBM, now offer similar services.

All this might convince investors to bet on Loudcloud, but is unlikely in itself to revive their enthusiasm for technology IPOs. It does not help that bad news is emerging almost daily. On March 7th, for instance, Yahoo!, the world's biggest web portal, said that revenue and profits for the first quarter of 2001 will come in well below expectations, due to weak advertising sales, and that its chairman and chief executive, Tim Koogle, will give up the latter job.

More important, past IPO excesses have had a lasting effect on investors' appetite for technology listings. Of all the Internet IPOs in 1999 and 2000, only a few are trading above their offer price. Individual investors in particular feel that they have been taken for a ride by the hype brigade of venture capitalists, investment banks and the press. The danger, though, is that investors will now turn their backs on genuinely promising start-ups. Loudcloud might even be one of them.

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AMERICA'S ECONOMY

What a peculiar cycle

Mar 8th 2001
From The Economist print edition

For the past ten years America has enjoyed a remarkably prolonged economic expansion. Does the "new economy" have a new kind of business cycle?

AMERICA'S economic expansion is already by far the longest in its history. If the economy proves to have grown during the first quarter of this year—opinions are divided on whether it will—then the expansion is exactly ten years old. This means that it has lasted more than twice as long as the average expansion since the second world war. The average forecast for growth in America in 2001, according to *The Economist*'s poll of forecasters, has fallen from 3.5% in October to only 1.6% this month. Most economists still believe that a "recession" (two consecutive quarters of contracting output) can be avoided. Others doubt it. In either case, most base their view on a particular understanding of business-cycle economics. Perhaps, in light of recent developments, that understanding needs to change.

Most economists—including, it seems, Alan Greenspan, the chairman of the Federal Reserve—are assessing the current downturn as if, in key respects, this were a business cycle like any of the other nine that America has experienced since 1945. A main braking force, they believe, comes from the efforts businesses are making to shrink their inventories, which have grown because of slowing demand. If they are right, the interest-rate cuts that have already been made, together with others in the pipeline, should be a swift, effective remedy. They will revive demand and narrow the gap between desired and actual inventories. The question is, does the cycle still work this way?

One observer who demands attention thinks not. Larry Summers, who has just retired as America's Treasury secretary, has recently argued that America's current cycle is fundamentally different from its post-war predecessors—though not because it is "new". He argues that it has more in common with economic cycles as they worked before the second world war—or even, wait for it, with Japan's during the late 1980s. That is a comparison he thought it unwise to draw while still in office. Mr Summers still hopes that a recession will be avoided in America. But if he is right about how things now work, predictions based on orthodox business-cycle calculations are of little use.

In the Bible, seven years of plenty were followed by seven years of lean. Business cycles have never been that regular. Since 1945, expansions have varied in length from 12 months to the current 120 months and counting (assuming the economy has not already contracted). Recessions have ranged from six months to 16. The deepest modern recession was in 1973-75, when output dropped by 3.4% from peak to trough. The shallowest was in 1969-70, when output barely dipped (see table 1).

No two cycles are identical, yet the pattern during the past half-century has been reasonably familiar. After several years of expansion, aggregate demand outpaces supply. This causes inflation to accelerate. The Fed raises interest rates, which squeezes demand. As inventories build up, firms cut production. The economy moves into recession. Next, the Fed cuts interest rates. Demand recovers, and so does output. The next expansion has begun. This sequence once prompted Paul Samuelson, one of the past century's most celebrated economists, to remark that American recessions come stamped "Made in Washington by the Federal Reserve". This time, if the economy does move into recession, it will not be because of high interest rates.

Every recession during the past four decades has been preceded by a marked rise in inflation. During this expansion, inflation has remained relatively subdued. As a result, the Fed raised interest rates by only one percentage point between the summer of 1998 and their peak in 2000; real interest rates actually fell slightly over that period. Demand is currently weakening not because of a sharp increase in interest rates, but because of factors such as weaker profits, falling share prices and falling investment.

The post-war blues 1

Duration and depth of US recessions

Recession dates	Duration in months	% fall in GDP from peak to trough
1948-49	11	3.6
1953-54	10	1.9
1957-58	8	3.2
1960-61	10	0.5
1969-70	11	0.1
1973-75	16	3.4
1980	6	2.2
1981-82	16	2.8
1990-91	8	1.3

Sources: Thomson Financial Datastream; NBER

The trouble with low inflation

Economists at Goldman Sachs, as opposed to stockmarket analysts at Goldman Sachs, have long been warning about the “dark side of the new business cycle”. Greater vigilance from central banks, industrial deregulation and ample productive capacity (as a result of strong investment) have all helped to hold down inflation. The traditional trigger of recession, therefore, has not been pulled. Deregulation and new technology may also have made it easier for firms to avoid the build-up of unwanted staff and inventories, another precursor of traditional recessions. As a result, the expansion has endured for longer than usual.

The snag is that longer periods of expansion allow other sorts of imbalance—notably, personal and corporate debt, and overinvestment—to build up instead. Lulled into a sense of security, with expectations of everlasting prosperity, lenders relax their standards, and consumers and investors lose their inhibitions about borrowing. Lenders and borrowers alike take bigger risks, though it does not feel that way. Fuelled by credit and optimism about future profits, investment increases and asset prices soar. Success breeds success—but then, at some point, excess. Eventually, overinvestment reduces the return on capital and firms decide to cut their spending on capital. Consumers feel overburdened with debt and increase their saving. Optimism gives way to pessimism, and demand falls sharply. In the 19th and early 20th centuries, in fact, this was the typical business-cycle pattern.

The “investment boom and bust” model seems a far better way to understand the current cycle than the usual one based on rising inflation and higher interest rates. This has two important implications for policy.

First, if the American economy does now slide into recession, interest rates may be less effective than usual in reviving demand. Consumers may be too intent on saving more, and businesses on reducing their debts and excess capacity, to pay much attention to a reduction of half a point here or there in the Fed Funds rate. This, in turn, raises the possibility that the recession, if it starts, could be deeper or longer than its recent predecessors.

Second, idle as it may be to point this out now, interest rates should have been raised earlier in the expansion. With hindsight, the reason for this was not to deal with the risk of imminent inflation, as some, including this newspaper, argued at the time—incorrectly, as it turns out. The reason was that it would have been better to temper the boom, curb overinvestment and restrain the rise in equity prices. The cost of that policy would have been somewhat slower growth. The benefit would have been an economy that is not so financially extended—one that is less, as it may prove, financially fragile.

A spoke in the wheel

There is another way to look at it. Suppose that the technological revolution of the late 1990s lifted the return on capital and increased opportunities for profitable investment. It probably did so—if by less than the new-economy zealots argued at the time, then by more than the recent wave of new-economy pessimists now suppose. This increase in profitable opportunities means an increase in the demand for capital. It raises the equilibrium real rate of interest, the rate at which the long-term supply of capital (saving) matches the long-term demand for it (investment). But real interest rates have not risen, nor has the domestic supply of capital (despite the government’s budget surplus). American households are

saving less, much less: they now have “negative saving”, spending more than their income.

Monetary policy that was “neutral” in the face of a breakthrough in technology would allow real interest rates to rise a bit. If instead the central bank holds interest rates down, this will further fuel the investment and stockmarket boom, and further depress personal saving. An important implication is that it is not enough for central banks to focus narrowly on consumer-price inflation. They also need to keep a keen eye on asset-price inflation, rapid credit growth and saving-investment imbalances. Admittedly, this is exceptionally difficult at a time when, thanks to a boom in investment, capacity has expanded and inflation is under control. Nobody said monetary policy is easy.

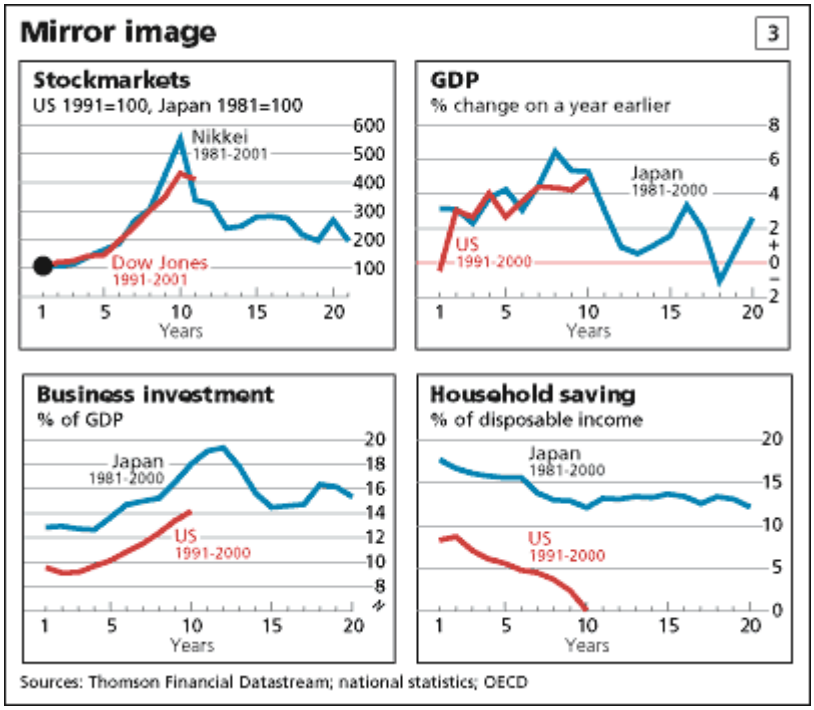
America’s recent combination of a sustained boom in business investment together with a deep slump in household saving is historically unprecedented. As a result, private-sector net saving, the difference between the total saving and investment of households and firms (that is, the extent to which they need to borrow to finance their spending) has moved dramatically, from a surplus of 5% of GDP in the early 1990s to a deficit of 6% last year (see chart 2).

To find similar recent cases, it is necessary to look abroad—disturbingly, to Japan, Britain and Sweden in the late 1980s. All three experienced a similarly dramatic deterioration in private-sector net saving; in their cases, the switch coincided with booms not just in share prices but also in the price of property. When asset prices tumbled, firms and households tried to restore their financial positions and net saving increased sharply. This caused deep recessions. In Britain, during the boom, private-sector net saving fell from plus 5% in 1985 to minus 6% in 1989; then, as recession took hold, it reversed even more abruptly, to plus 6% by 1994. Japan’s net saving fell from plus 5% in 1986 to minus 2% in 1990. Later, it rebounded. Again that caused a deep recession, from which the economy has yet to recover, ten years on.

This old-fashioned kind of recession may in general tend to be longer-lived, as well as deeper, than the ordinary post-war sort. Stephen Roach, an economist at Morgan Stanley, points out that since 1945 the average recession has lasted 11 months; between 1854 and 1945 the average was 21 months. He argues, plausibly, that this is because it takes longer to purge financial excesses than to tame inflation.

A return to investment-boom-and-bust cycles need not mean that output will become as volatile as a century ago. Obviously, many other things have changed since then. The composition of output has shifted heavily from manufacturing to services, which tend to be less cyclical. Taxes and public spending—including “automatic stabilisers” such as unemployment benefits, which rise in recession and so cushion demand—have vastly increased. Deposit insurance and stricter bank regulation help to prevent the financial crises and panics that made recessions so ferocious a century ago.

Unfortunately, the comparison with Japan—absurd as it seems to most Americans to draw any such parallel—cannot be so easily discounted as the comparison with the distant past. America in the late 1990s had much in common with Japan in the 1980s (see chart 3). Both economies displayed some classic symptoms of economic and financial bubbles: rapid monetary growth, surging share prices, rampant GDP growth and a boom in investment. In both America and Japan during their booms, inflation remained low so central banks had no reason to raise interest rates despite rapid monetary growth. As a result, the cost of borrowing was especially cheap relative to the expected gains in asset prices.



Terrible twins?

The path of share prices in America over the past decade looks similar to that of Japan in the 1980s. Since the Tokyo stockmarket peaked in 1989 share prices have fallen by 70%. In America, only Nasdaq has threatened to challenge that achievement: it is down by around 55%. So far, America's widest stockmarket index, the Wilshire 5000, has fallen by a modest 20%, and the Dow Jones Industrial Average by less than that. But there may be further falls to come. By most equity-valuation measures, American shares are still dear.

True, Japan's bubble (the term is no longer controversial in that case) was all-encompassing. Property as well as equities were caught up in it. America's property market has seen nothing remotely on the scale experienced in Japan. In 1989 the grounds of the Imperial Palace in central Tokyo were supposedly worth more than all the real estate in California. On the other hand, America can boast some similarly outlandish valuations in its equity market—as when, in 1999, an online travel agency, was deemed more valuable than America's three biggest airlines. Also America's equity-market exuberance has had a much bigger effect on the economy than the Japanese equivalent, because shares are more widely held in the United States. At the beginning of 2000, American households owned shares worth 180% of their disposable income. When the Tokyo stockmarket peaked in 1989, households' shareholdings were worth only 90% of their income.

All very well, you may say, but America has had a technological revolution: this justifies at least some of the surge in asset prices. So it does, but it is still sobering to recall that much the same was said about Japan in the 1980s. Back then Japan was also thought to have discovered a superior economic model. As in America today, it was believed that Japan's growth had increased permanently and substantially thanks to enormous investment. Japanese business investment jumped from 13% of GDP in the early 1980s to more than 19% by 1990; American business investment has jumped from 9% of GDP to 15% over the past decade. And during the 1980s, growth in labour productivity accelerated in Japan by even more than it has in America in recent years. All the signs are that some of America's productivity improvement, unlike Japan's, will be sustained. But it is too soon to take that entirely for granted.

Banking on prudence

As well as similarities such as these, too often ignored, there are two crucial reassuring differences. First, markets and institutions in America and Japan are quite unalike. Second, policy in America is likely to be far better conducted than it has been in Japan.

After Japan's bubble burst, banks continued to lend to favoured firms that should have been allowed to fail. The availability of finance and Japan's traditional policy of "lifetime employment" discouraged firms

from cutting investment or workers as profits fell. As a result, Japanese firms were slow to eliminate their overhang of capacity. In America, such adjustment is likely to happen more rapidly because labour and product markets are much more flexible. Other things equal, that could mean a sharper contraction at the start—but it would help to prevent worse problems later.

American firms are more transparent. Nomura, a Japanese stockbroking firm, has recently published a handy comparison of America in the 1990s with Japan in the 1980s. It points out that Japanese companies and banks tried to conceal their financial problems through shady accounting practices. In all manner of ways, Japan's financial system was weaker than America's. During the bubble, firms depended almost entirely on banks which, in turn, relied on shares and property as collateral for lending. That left banks completely exposed to falling asset prices.

In contrast, America is less dependent on banks for credit, and more dependent on capital markets, so any losses are less concentrated on banks and more evenly spread around the economy. America's double-pillared financial system with its well developed capital markets makes it easier for firms to switch sources if for any reason bank credit dries up.

That is not to claim that American firms and banks have been as prudent as they should have been. Far from it. There has been a clear deterioration in the quality of lending and default rates are at their highest since the last recession. Many companies have taken on huge amounts of debt. And American tech-stock analysts have pioneered some shady accounting practices the Japanese never dreamed of. All in all, though, the American economy, despite its financial overstretch, looks sounder now than Japan's was before the crash.

Learning from mistakes

Arguably, errors in policy bear even more of the blame for Japan's prolonged stagnation than the bursting of the bubble itself. In 1990, before the recession started, Japan's budget surplus was actually bigger in relation to its GDP than America's is today. After years of throwing money at doubtful public projects in a bid to get the economy moving again, the Japanese government has turned this surplus into the biggest deficit of any rich country—while failing to revive the economy. Much of the spending was wasted on building bridges to places people did not want to visit, or on propping up failing industries that would have been better left to die.

Monetary policy has been worse. The Bank of Japan was slow to ease monetary policy after the bubble burst. The bank did not cut interest rates until the summer of 1991, 18 months after share prices collapsed. By then business confidence had already slumped. The Bank of Japan has dragged its heels ever since, allowing deflation to take hold and so swell the real debt burden of companies. The Fed's prompt interest-rate cuts in January show that it can be relied upon to act more swiftly.

America, however, does have two disadvantages, which will make things harder for the Fed if boom turns to bust. First, America's personal saving rate is now negative; Japanese saving remained high. If American share prices fall and unemployment rises, households could feel under greater pressure to increase their saving abruptly. Second, Japan had a large current-account surplus when the bubble burst; America has a large deficit. This makes it more vulnerable to a run on the dollar if foreign investors lose their appetite for American assets. A falling dollar would complicate monetary policy.

The character of this current cycle, and the similarities it highlights between America now and Japan in the 1980s and 1990s, are enough at least to raise the possibility that America may face a recession this year—and maybe a bad one—rather than a mere pause. Even when proper weight is given to these risks, which it rarely is, the idea that America could follow Japan into a decade of pitiful underperformance still seems utterly incredible. Let us hope it still seems so a year from now.

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A sapling's sound roots

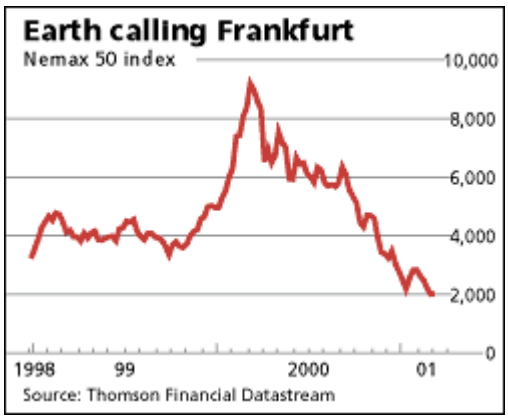
Mar 8th 2001 | FRANKFURT
From The Economist print edition

Tumbling share prices and tales of sharp practice have not been helpful to Germany's young "equity culture". Yet Germans' interest in the stockmarket is likely not merely to survive but to grow

A MAN can take only so much. This year Boris Becker has suffered a messy divorce and a messy paternity suit. Why ask for more trouble? A few months ago, the tennis star was thinking of floating his sports-marketing agencies, BBM and BBI, on the stock exchange this summer. Not now. "At the moment," he said this week, "it would be suicide to bring a firm to the market."

You can see his point. Last spring, Germany was share-crazy. Gone was the image of a nation dourly stuffing its spare cash into a safe-as-houses, low-interest *Sparbuch* savings account. Money poured into initial public offerings. The boom in tech stocks carried Frankfurt's Neuer Markt, Europe's biggest growth-stock market, to giddy heights. Germans were opening share-dealing accounts—online, naturally—at a furious rate. Entrepreneurs symbolising the *Zeitgeist* were celebrated in a surging business press.

In the past year, however, one icon after another of Germany's enthusiasm for equities has taken a beating. The Neuer Markt has fallen even further than its big cousin, America's Nasdaq, having dropped by 80% from its peak a year ago (see chart). A good dozen firms in the Nemax 50 index are worth less than a tenth of their peak values. In large part, this reflects the loss of faith everywhere in tech stocks. But jiggery-pokery in the market has not helped. Some companies stretched the truth, or snapped it, in their sales and profit forecasts. Some share dealings by company insiders look suspicious.



Granted, the Neuer Markt is only one bit of the wider stockmarket. Even at its lunatic height, its entire market capitalisation was just one-quarter that of the 30 companies in the blue-chip Dax index. But the Dax has not shone either, losing more than 20% since last March.

Meanwhile, the collapse in the share price of one blue-chip, Deutsche Telekom (DT), has a special resonance. When the state first sold a stake in the telecoms giant to the public in 1996, the shares were touted as *Volksaktien*—people's shares. This exercise in popular capitalism created more new shareholders than any other single event. Yet DT's shares have sagged like telecom stocks everywhere. At around *euro*28 ($26.10), they are 70% below their peak; only last June another helping of DT shares was floated at *euro*66.50. The German government, still DT's biggest shareholder, and fellow board members have had to defend Ron Sommer, the chief executive, against calls for his head. Even the chancellor, Gerhard Schröder, has weighed in as a tipster, praising the shares' sound underlying value.

Disasters like these, you might imagine, would be enough to kill Germans' interest in stocks and shares. A strengthening economy would help—but there is no sign yet of relief on that front. Growth in output slowed in the second half of 2000, and economists are trimming their forecasts for GDP this year. In February, unemployment rose a bit more (though the rate was unchanged at 9.3% of the workforce). There is a hint that the gloom might indeed be hurting share ownership. Thanks to a drop in the number of employee-shareholders, the number of Germans owning shares directly fell slightly, to less than 6.2m, in the second half of last year, according to the Deutsches Aktieninstitut (DAI), which promotes share ownership.

Despite everything, interest in equities is alive and kicking. A growing number of Germans are entrusting

at least some of their wealth to the stockmarket, if not directly, then through mutual funds (unit trusts). Investors in mutual funds grew by three-quarters of a million in the second half of 2000. One way or another, one in five Germans now owns shares. That is a much smaller proportion than in America, Britain or some other continental European countries. But the figure has doubled since 1997.

In the first couple of months of this year, fund managers say, money has continued to flow into mutual funds. Not at the same pace as a year ago, says Steffen Selbach of DGZ-DekaBank, the fund-management arm of Germany's savings banks, but faster than the average for the past few years.

How so? One reason, says Mr Selbach, is that people really do believe that equities provide better returns in the long run than savings accounts. Investors are planning to leave money in for several years, rather than hoping to make a killing in a few months. Most have also twigged that they will sleep more soundly by putting their money in a diversified fund. "People are calm, very calm," says Mr Selbach. "The investor in Germany has grown up. Finally."

This equity culture is in fact older than the usual headlines suggest, and has had time to put down roots. At about 4m, the number of direct shareholders was fairly constant between 1992 and 1997, yet the trend towards investment in funds was well under way. The value of equity funds trebled between 1991 and 1995, and more than doubled again by 1997, the year the Neuer Markt was born.

Steady investment in equities is getting another push from the government's plans to reform the pension system. The idea is to cut the value of the state pension, relative to earnings, and to encourage private provision. Leander Hollweg of Tecis, a financial-advice firm serving "the normal, average household", says that Germans have realised they will have to save for retirement, rather than rely on the state. Although the details of the reform are not yet clear—for instance, which schemes will qualify for tax breaks—people are already putting money aside for the long run.

Even so, shareholders' champions think that regulators could do more to strengthen confidence in share ownership. A new rule obliges directors of Neuer Markt companies to disclose their share dealings within three working days. The proposed penalties are not tough enough, says Rüdiger von Rosen of the DAI: miscreants should surrender any profits they make. Klaus Schneider, chairman of the Association for the Protection of Small Shareholders, a pressure group, wants disclosure in advance.

Similarly, as Germans invest more in equity funds, their pensions will depend on how closely fund managers watch the way companies are run. DWS and Union Investment, two big fund-management firms, make a point of turning up to shareholders' meetings, criticising and praising bosses as they think fit. Other fund-management companies, says Mr Schneider, are not active enough.

The spreading equity culture has an air of permanence that hard statistics cannot convey. There is softer evidence in German living rooms. Since last autumn a live, four-minute bulletin on the *Tops und Flops* of the day, that runs just before the evening news, has become a fixture on national public television. The style is chatty and quick—something like a sports report. Just the place, one day soon, for more news about Mr Becker's business empire.

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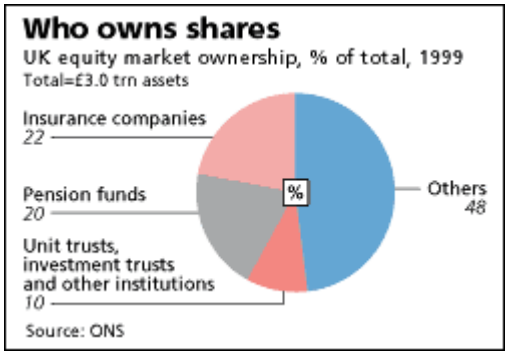
Institutional investors in Britain

Throwing the book at them

Mar 8th 2001
From The Economist print edition

GORDON BROWN, Britain's chancellor of the exchequer, announced a review of institutional investment in his budget a year ago. He was convinced that small, innovative companies were being starved of capital, particularly by Britain's institutional investors. He appointed Paul Myners, chairman of Gartmore Investment Management, to recommend measures to promote venture capital, or private equity as it is also called. Mr Brown, in turn, would win plaudits for laying new foundations for Britain's long-term growth.

Mr Myners has now produced his report. It is an important document, though not because of its recommendations about private equity. Mr Brown had never made a good case that deserving unlisted companies are starved of capital, still less that British pension funds would better serve their clients by investing more in them. Mr Myners's recommendations largely side-step the chancellor's intentions. Yet, if carried out, as the chancellor says they will be, they would add up to the most radical shake-up of investment management in decades.



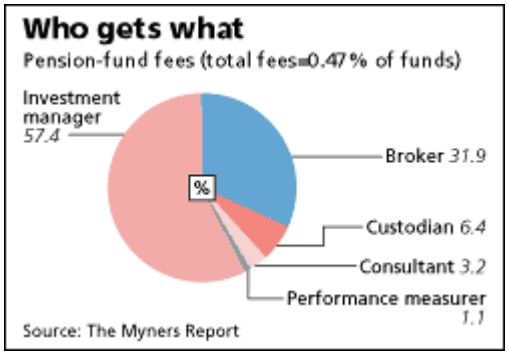
At first glance, British institutional investment does not reveal deficiencies that require root-and-branch reform. Britain's pensions industry is huge, with about £800 billion ($1.2 trillion) under management, and is relatively successful. The largest pension-fund managers, such as Merrill Lynch Investment Managers, Schroder Investment Management, Phillips & Drew and Gartmore, have produced real average returns of about 13% a year over the past two decades, investing mainly in quoted equities and gilts (government bonds). That seems a decent return, when you consider that the average long-run return on British equities is 9%.

Mr Myners still thinks institutional investors need to mend their ways. He calls for changes in fund-management practices to produce more accountability, more transparency and more professionalism. Among other things, he wants an end to "soft" commissions, which are inducements by securities firms to ensure investment managers channel share-trading business their way. He calls for fund managers, pension-fund trustees, and consultants who advise the trustees all to agree to a new code of best practice on how investment decisions are taken. He wants more care taken in the way funds allocate their assets, the better to suit their clients' long-term needs. (Mr Myners comes from a firm that specialises in "active" management; he decries the trend towards "benchmarking".) And he wants fund managers to get involved when companies they have invested in underperform.

The proposal to end soft commissions is perhaps the biggest surprise. Mr Myners is right. The way they are paid is far from transparent. The pension-fund client has no say in deciding which brokers get a fund's share-order business. Besides, the inducements (often in the form of dealing screens, say, or extra research) may prevent fund managers from seeking out the best services the market has to offer. Doing away with soft commissions would force fund managers to think of the cost of commissions paid to brokers as a normal business expense. They would then think hard about where best to buy the services they currently get on a soft-money basis. They might, for instance, produce more research in-house, to the chagrin of securities firms. Clients would know what they were paying for.

Mr Myners's report spares no one in the industry's decision-making chain. Pension-fund trustees are too amateurish and spend too little time looking after the funds in their care, he says. More than 60% of trustees surveyed by Mr Myners have no investment qualification; they blindly follow the investment and actuarial advice of "consultants". These, in turn, are too few. Just four big players—Watson Wyatt, William Mercer, Bacon & Woodrow and Hymans Robertson—dominate the investment-consultancy

business in Britain. Their performance is not assessed, and their twin duties (investment advice and actuarial analysis) create a conflict of interest.



Fund managers are in the dock as well, partly for their herding instinct. “Peer-group benchmarks” incite funds to copy others, even if that fails to serve the needs of their clients, and they stifle investment in more imaginative classes, such as hedge funds or venture capital. All parts of the chain, says Mr Myners, need to think much more about asset allocation.

Mr Myners’s proposed code of best practice would call for trustees to have greater expertise and support, and require them to be paid for being legally responsible for pensioners’ savings. Fund managers should be more formally obliged to assert themselves in exercising shareholder rights, actively intervening in underperforming companies. The obligation to be assertive is borrowed from America. Yet there, its success has been limited, at best. Also, fund managers might seek to shun a reputation for intervening in companies’ management if they thought it might lose them pensions business in the long run.

Amongst many other recommendations, Mr Myners calls for the “minimum funding requirement” to be scrapped. The requirement, drawn up after Robert Maxwell robbed his companies’ pensions funds in the early 1990s, attempts to assess the present value of pension funds’ future liabilities, taking the yield curve on gilts as its reference point. In that way, it can act as a deterrent to taking risks—risks such as investing in the private equity that Mr Brown was worried about when he started this ball rolling.

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Banks behaving badly

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ONCE again, Britain's banks stand accused of mistreating their customers. This time it is the owners of small businesses who are suffering, according to the Competition Commission, which this week announced a preliminary conclusion that 12 banks are operating a "complex monopoly" in the supply of banking services to small and medium-sized businesses (SMEs) in Britain. A complex monopoly means that the banks are restricting competition without cartel agreements. If the Competition Commission goes on to find that this situation acts against the public interest, the banks will be forced to do something about it.

Reuters

Small-business Byers

In reality, only four of Britain's banks face the full wrath of the competition authority. Barclays, HSBC, Lloyds TSB and the Royal Bank of Scotland have a combined market share of almost 90% of the SME market. In addition, the competition authority has drawn attention to the fact that few small businesses ever move from these banks to others.

Is that because they have no choice? The competition watchdog suspects that the banks use devious means to stop SMEs moving, for instance, by privately negotiating favourable terms for those that seem most likely to leave. Another trick is to require small businesses that want to borrow or make deposits to open a current account as well. That way, they are prevented from shopping around for the best deal on each product.

New competitors and direct banking methods such as the Internet may offer a solution, thinks the Competition Commission. Alliance & Leicester launched a new service in October last year which offers a current account for a flat fee of £10 ($15) a month, in contrast to the big banks, which charge for every transaction. It also pays interest on current accounts to business customers that use its Internet banking service. Most of the branch-based providers offer no interest on current accounts at all.

Now the big four banks are waiting to see what remedies would be enforced against them if the Competition Commission decides in June that their complex monopoly operates against the public interest. Lloyds TSB will be watching especially closely, since one of the reasons the industry minister, Stephen Byers, referred its bid for Abbey National to the commission last month was that the merger would remove a potential new competitor in the SME market.

The most draconian measure would be to force the banks to sell parts of their SME businesses, a measure envisaged in a report on banking services by Don Cruickshank last year. Small businesses would probably protest at being shunted over to another bank and branch network not of their choosing. Some argue instead for price caps on transaction charges for small businesses, others for a requirement to pay interest on current-account balances. The banks would fight hard against this kind of regulation.

Far better would be remedies that encourage more competition in the SME sector. Banks should be required to improve the transparency of their pricing. At the moment it is often difficult for small businesses to know exactly what they are being charged, so new entrants find it hard to compete effectively on price. Standardised credit histories for SMEs could be devised, so that banks will readily accept new, unknown customers. If more light can be let in, small businesses will have only themselves to blame if the big banks still find ways to mug them.

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Economics focus

Big Oil and its subsidies

Mar 8th 2001
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America's new administration wants to give oil companies new "incentives". Critics deplore such "handouts". Who is right?

THE question of whether governments are justified in subsidising energy firms is back on the agenda. George Bush has declared that there is an energy "crisis" in his country, and insists that more domestic supply is the answer. Allies in Congress have devised an energy bill laden with incentives for domestic oil and gas exploration. Mr Bush's new budget also calls for a variety of enticements designed to get American oil gushing.

Critics have pounced on such proposals as thinly veiled handouts for Mr Bush's cronies in the business—who, the critics insist, already receive plenty of fat subsidies. They point to earlier studies, such as one done by Greenpeace, that reckon the oil industry receives between $15 billion and $35 billion a year in subsidies.

Is that so? Exactly, or even roughly, how much the oil companies already receive in subsidy turns out to be a complicated question. Ronald Sutherland, an energy economist affiliated with the Cato Institute, a think-tank in Washington, DC, has used statistics from the Department of Energy to argue that oil gets rather little. All told, after subtracting this and allowing for that, he reckons oil receives far less than a tenth of the overall federal energy-subsidies pie, which was worth between $8.6 billion and $11.3 billion in 1999.

He goes further. Far from being big beneficiaries of the federal government, the oil companies are net victims. He points to gasoline taxes and to environmental regulations, such as fuel-efficiency standards for new vehicles. By his reckoning, the chilling effects on oil producers and consumers of these government actions far outweigh the small subsidies received by the industry. What is more, he argues, some of the taxes collected from oil consumers for the construction and maintenance of roads (which you would expect to benefit oil consumers) are actually diverted to the general revenues of state and local governments, or towards mass transit.

Mr Sutherland succeeds in shooting down the inflated calculations of Greenpeace and others. Still, he too is failing to present the whole picture. That is because, as the author himself concedes, a variety of implicit subsidies are involved in getting oil from the gusher to the gasoline tank. Chief among these hidden fiscal costs are those related to national security and to the environment.

Slippery slope

The extent to which oil is subsidised by America's defence budget is a matter of lively debate among energy economists. Some point to the demands of defending Middle Eastern oil fields, and have suggested that defence costs add between $10 billion and $20 billion a year in subsidies to the true cost of oil. Mr Sutherland pooh-poohs such assessments. He points to studies suggesting that even if America greatly reduced its imports of oil, it would not necessarily reduce military outlays. Perhaps that is true, but such an argument fails to persuade, on two counts. First, it can never happen: America's appetite for fossil fuels is just too big, and its domestic reserves too small, for government to subsidise its way to self-sufficiency. Second, such a view neglects military operations such as the Gulf war of a decade ago, which few would deny was motivated at least in part by concerns over oil.

Another snag involves so-called externalities. Guzzling gasoline clearly carries costs, to human health as

well as to the environment, that many believe are not reflected by the price of that fuel. Cato's analysis points to studies suggesting that "the external environmental costs of gasoline were 'internalised' completely by regulatory action and overtaxation for other purposes." However, other studies suggest just the opposite—that such costs may run to tens of billions of dollars a year.

Such a view is especially popular in Europe, but it may be closer to the truth in America, where taxes on gasoline are much lower. What is more, the taxes that are imposed on gasoline in the United States are anyway already earmarked for specific purposes that have nothing to do with human health or the environment. Some therefore argue that these taxes should not be double-counted as part of the "internalisation" of the costs to society.

Other sorts of implicit fiscal advantage enjoyed by fossil fuels are even harder to quantify. A new report—this one by Green Scissors, an alliance of American green organisations and taxpayers' rights groups—tries to quantify all the indirect subsidies. For example, costly work done by the army corps of engineers to dredge waterways in order to ensure safe passage for oil tankers plainly benefits the industry, yet nowhere does it appear on the books as an oil-industry subsidy. Until recently, oil companies did not use market prices for oil to determine the royalties they owed for drilling on federal land; the report reckons this has cost taxpayers some $68m a year.

Another example involves America's Export-Import Bank, a government agency that provides loans and investment guarantees for overseas projects. Last year, the agency devoted over $2 billion (nearly a fifth of its portfolio) to funding projects such as power plants, fossil-fuel extraction and pipelines. Admittedly, it is again unclear how much of this should be regarded as a subsidy: some of the money has nothing to do with its official purpose. In one infamous case, the Ex-Im Bank joined the World Bank in helping to finance a controversial oil pipeline in Chad and Cameroon. Chad's government, it has since been reported, spent $4.5m of that foreign money buying weapons.

The extraordinary complexity of the various "taxes" and "subsidies" affecting the oil industry is revealing in itself—eloquent testimony to politicians' desire to meddle, and to obscure the true cost of their meddling. Mr Bush is wasting no time in following that tradition. If you ask whether any subsidies for oil are necessary, in economic terms, the answer is clearer. There is no reason whatever why American taxpayers should subsidise such a well-capitalised and hugely profitable venture as the oil industry, least of all when projects involving clean renewable energy receive much less favourable treatment. Big Oil's free ride may be less outrageous than some allege. But the industry should pay its way—externalities included—in full.

The papers referred to are: "'Big Oil' at the Public Trough? An Examination of Petroleum Subsidies", by Ronald Sutherland; Cato Institute, February 2001. "Green Scissors: Cutting Wasteful and Environmentally Harmful Spending", by Friends of the Earth, Taxpayers for Common Sense, US Public Interest Research Group and others, February 2001.

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Coffee

Trouble brewing

Mar 8th 2001 | SAO PAULO
From The Economist print edition

AP

YOUR morning espresso may not be any cheaper, but the price of coffee beans on the commodities exchanges has crashed in recent months, despite a scheme by the world's producers to hold back 20% of their exports. This week, the Association of Coffee Producing Countries (ACPC) sent in a Swiss inspection firm, SGS, to check the warehouses of member countries: there are suspicions of cheating. And eight Latin American coffee-growing nations met in Guatemala to discuss a separate price-boosting proposal, in which low-quality beans would be bought up and put to other uses—made into fuel or fertiliser, for instance.

The ACPC's export-retention plan aims to push the price of a mixed basket of various grades of coffee above 95 cents a pound. Since the plan started, last October, the price has fallen to half that (see chart). Almost all growers are losing money; in some countries, berries are being left to rot on the bushes.

The retention scheme's failure has provoked a backlash in Brazil, the world's largest producer. Its growers suspect that, while they are holding back, others are grabbing their business. Luiz Hafers of the Brazilian Rural Society, a farmers' group, says that the scheme is a "catastrophe", and that instead of supporting prices it is depressing them by causing uncertainty. It has all added to a feeling among Brazilians that the rules of world trade are stacked against them.

Colombia, the second-largest coffee producer, has been calling for the return of the International Coffee Agreement, a system of quotas which coffee-drinking nations helped to police, and which collapsed in 1989. This time, there seems no chance of persuading consuming countries to support a plan that would make their cuppa more expensive. Meanwhile, this week's meeting in Guatemala, to talk about withdrawing low-quality beans, ended with little more than a statement of intent. It will be hard, given the participating countries' economic problems, to finance and then enforce a scheme big enough to make a difference.

So it would seem that it is either the ACPC's retention plan, or a free-for-all. Some Brazilian growers might prefer the latter. They have made big productivity gains in recent years and got a further competitive boost from the country's devaluation in 1999. They might be able to survive a period of depressed prices while other, higher-cost producers were forced out. Still, Oswaldo Aranha of Cecafé, an association of Brazilian coffee exporters, thinks this might backfire: in many other producing countries, coffee is grown on family farms which are so dependent on the crop that they might go on producing, however low the price fell. More efficient producers, such as Brazil's big plantations, might then be squeezed out.

The ACPC's secretary-general, Roberio Silva, argues that the retention scheme has not yet had enough time to prove itself: some big producers, like India, have only just started organising their official warehouses and financing packages. As the scheme gears up, it should start to lift prices in the coming months. However, Mr Silva admits, since the retention is only temporary (initially for two years), it will not address the fundamental problem, which is that supply of coffee exceeds demand—by up to 10%, some analysts say—and that production is growing more than twice as fast as consumption.

After a sharp frost in 1994 wiped out much of Brazil's harvest prices soared and producers around the world, hoping the high prices would last, boosted their output. Vietnam, for instance, has grown from nothing to become the third largest producer. With the world awash with coffee, and growers reluctant to cut production, the only solution, says Mr Silva, is to increase demand through a giant marketing campaign aimed, for instance, at wooing younger consumers away from fizzy drinks. This would be expensive, and coffee growers and exporters are reluctant to put up the money. Barring freak weather, coffee looks set to stay cheap.

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Eastern European securities

Like Uncle Sam

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From The Economist print edition

IF YOU want a big, smoothly functioning market for capital, you have to protect investors from mischief. For any emerging economy trying to turn foreign and domestic savings into productive assets, that ought to be an obvious conclusion. Yet some transitional economies have learned the lesson better than others.

Anybody who doubted the lesson could consult a stack of papers from a research team led by Harvard University's Andrei Shleifer and the University of Chicago's Robert Vishny. Over the past five years, the two have studied the link between investor protection—notably, measures to entrench the rights of minority shareholders, or to require disclosure of corporate information—and growth in financial markets. The numbers make it plain there is indeed a link, but did effective regulation promote financial development, or was it the other way round?

To establish the direction of causation, the researchers needed to find something that affects the extent of investor protection but that is not affected by big, deep capital markets. They settled on legal tradition. Countries with regulatory codes descended from English common law tend to have stronger investor protection than countries with civil-law traditions founded on Roman law; presumably, on the other hand, the extent of modern financial development cannot have affected the historical legal tradition. So the share of investor protection that can be traced to a country's legal tradition—and it is usually a big share—is likely to be a cause of financial growth.

These investigations shed an interesting light on recent changes in Eastern Europe's regulatory regimes. Most of the transitional economies had French- and German-inspired legal systems before communism. When the iron curtain fell, they had a chance to make a fresh start. The most ambitious reformers began to adopt American-style regulations derived from English common law. That process has culminated in Poland's new company law, which came into effect at the beginning of this year.

One of the new law's important provisions is that each share in a public company may carry only one vote. Under the old commercial code of 1934, which remained in force under communism, preferred shares carried up to five votes. Small groups of investors could control firms in which they owned just small stakes; cross-dealings between firms controlled this way could be used to siphon off the wealth of minority shareholders.

Poland's new law also permits small investors to band together to challenge a company's activity or accounts. At a general shareholder meeting, any group with 5% of the company can demand an independent audit. In the past, neither the meetings nor the ability to force action in this way were guaranteed. Those rights, along with one-share-one-vote, greatly helped the development of capital markets in the studies Mr Shleifer and his collaborators produced.

The head of the Warsaw Stock Exchange (WSE), Wieslaw Rozlucki, is a big fan of what he calls "the American sunlight principle". Like Arthur Levitt, the last chairman of America's Securities and Exchange Commission, Mr Rozlucki believes in full disclosure of corporate goings-on so that investors may judge companies' prospects for themselves in the bright light of day. He hopes Poland's new company law will help to bring the WSE's market capitalisation from 17% of Polish GDP (see chart) to the West European average of 60%.

Hungary, the Czech Republic, Slovakia and Slovenia are also inching closer to the West European standard. Budapest's exchange is the furthest along, and at 21% of Hungarian GDP its market capitalisation is bigger than the WSE's. Its investor protection measures are not quite as generous as Poland's: a block of shareholders must command 10% of a company's votes to demand an audit or meeting, and those votes can be attached to shares in ratios as high as ten to one. It is clear, however, that

Hungary and Poland, compared with others, have bridged the gap with the West.

Poland's reforms have spawned a derivatives market that last year traded more index futures than Finland, Norway or Portugal. Russia is trying to get into the act by reforming its own derivatives trading, with America's Commodities Futures Trading Commission (the Securities and Exchange Commission's little sister) as an adviser and model. Despite support in the Duma and the Kremlin, it may be both too early and too late. Too early, according to Sergei Mayorov of the Moscow Interbank Currency Exchange, because it will be five or ten years before Russian law and business schools produce enough graduates trained in derivatives. Too late, according to Mr Rozlucki, because Russia's financial practices are already so bad that only fundamental legal reform will set its markets on the right course. Calling Russia "a world of its own", he hesitates even to place it in the same category as its former satellites.

Even in Eastern Europe's most promising regulatory systems, enforcement remains a problem. The courts move ponderously, and judges often lack a sure grasp of the new laws. As a result, legal protection of investors does not yet always mean effective protection of investors. In the past ten years, some countries have made a good start, but Wall Street by the Vistula remains a rather distant prospect.

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Predatory lending in America

Loans for a better life?

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WHEN Citigroup bought Associates First Capital last September, it probably thought that it was taking no great risk. Here was a wonderfully profitable business, albeit one with a rather low-grade clientele. America's largest bank paid a cool $31 billion for Associates. How many Americans—prosperous Americans, at any rate—had even heard of the outfit? It makes its money, and lots of it, by lending to the country's poor, and to those whose credit records prevent them from borrowing elsewhere. "Consumer finance", people in the industry politely call it. "Predatory lending" is how some of its customers see it. Now, regulators are taking the same view.

On March 6th the Federal Trade Commission (FTC) charged Citigroup with predatory lending (the commission used that term), with combining, in effect, the tactics of a loan shark and a con-man. Hundreds of millions of dollars will be sought in damages. Already another kind of shark is out: law firms are soliciting clients of Associates for private litigation. Risk of penalties aside, this is the kind of publicity that Citi could well do without.

Associates, based in Texas, grew huge by supplying, as it liked to say, "one simple answer to all your needs", often to blacks or Hispanics. Lenders such as Associates, you might argue, provide a vital social service to America's unbanked: to make money from it, they naturally have to charge customers more than they would charge creditworthy types. Associates made a point of making it easy to take out loans. One advertisement cited by the FTC asked why students should "hassle with long application forms and even longer waiting periods?" The answer (not given in the ad) is that conventional student loans are usually subsidised by schools or government, and so are cheap. Associates charged interest that could be twice as high, or more.

The firm pushed money for helping an elderly parent, adding a pool, or buying a truck or boat. "You made the process painless," is a testimonial included at the end of its pitch, which, narrowly defined, is probably true. The message worked. According to the FTC, Associates had 3m personal loans, 480,000 home-equity loans in 1997, the most current figures available. It has a $30 billion loan portfolio. For Citi, the attractions were clear. Not only did it strengthen the bank's presence in a lucrative and growing end of the credit market. It also provided a way to channel deposits coming into Citigroup's vast retail network, at a cost of 1%, into loans charging 20%. Nothing at Citi's upscale businesses comes close.

The FTC admits that "predatory lending" is hard to define. One definition is lending that is profitable just from the repayment of interest, without the expectation of ever getting the principal back. To a loanshark, after all, someone who repays his principal is a customer lost.

Associates is not being accused in quite such terms. In essence, the FTC's case is one of deceptive marketing. Associates, now renamed CitiFinancial, touted "financial solutions" and "loans that make life better", which did nothing of the kind. According to the FTC, people swimming in debt were advised to refinance, or "flip", outstanding unsecured charges into home-equity loans, on the false promise that this would lower costs. Rather, borrowers paid higher rates at greater personal risk, because their home could be repossessed. Sales pitches based on "no up-front, out-of-pocket costs" would include huge arrangement fees. Comparisons of repayment plans for loans would fail to show that Associates' plan was cheaper, because a small detail was missing: the repayment of principal. To boost initial fees, Associates would "pack" on insurance charges for repayment in the case of illness or death. Debt collection was sometimes ugly, too: harassing telephone calls and the disclosure of debt to other firms.

Citigroup is rushing to show how much more "sensitivity" it is applying to the business these days. For instance, it has created a foreclosure unit that attempts to distinguish between customers who simply refuse to pay, and those who are victims of bad luck.

Sandy Weill, Citi's chief executive, may be thinking his firm has been struck by bad luck. Citigroup knew Associates was being investigated at the time of its purchase, but may not have seen how much the

regulatory environment was changing. Mr Weill knows the industry well, after using the acquisition of a consumer finance company, Commercial Credit, to create the foundation of what is now Citigroup. Associates itself had been owned by Gulf+Western and by Ford without creating much of a stir, even though, according to the FTC, it was already relying on the practices for which Citi is being prosecuted. Since 1998, the FTC has prosecuted 14 other consumer-finance companies. They were all small fry, and regulators never like to fish for only those.

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Quantum dreams

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In theory, quantum computers can do things ordinary computers cannot. In practice, a useful quantum computer is still a long way off

Get article background

LAST time a bunch of famous theoretical physicists got together to solve an engineering problem, the result was an atomic bomb. This time, the physicists donning engineer's caps have a much more innocuous goal: to construct a quantum computer.

Just as with the atomic bomb, the task has captured the interest of some of the world's top talent in the physical sciences. Like the ones at Los Alamos, these scientists have the assurance of knowing that their goal is at least theoretically achievable. The lure of explosive power is present too: mathematical proofs guarantee that quantum computers could crack problems beyond the reach of current computer technology, even at its hypothetical limits. And though the deadline is farther away than it was for the Manhattan Project, the clock is ticking for quantum computing, as well: sometime in the next decade or two, the chip industry will no longer be able to pack transistors any more tightly on to a piece of silicon, and will have to look for other ways to improve performance. A quantum computer would offer an elegant solution—if only one can be built.

On paper, at least, a quantum computer sounds fantastic. An ordinary digital computer relies on bits—binary digits, each either a zero or a one—to store information. But quantum theory states that subatomic particles can exist in multiple states simultaneously, a phenomenon known as superposition. An electron, for example, has a property known as "spin" that can be "up", "down", or a peculiar quantum combination of both at the same time. Using the spin of an electron to represent a bit of data thus allows two possibilities to be represented and manipulated at once. Each additional quantum bit, or "qubit" doubles the number of possible states that can be handled. That leads to an exponential growth in processing power: each operation in a two-qubit quantum computer can handle four possible states at once, and a 20-qubit device could manipulate over a million different states at once.

In the mid-1990s, researchers realised that this exponential scaling meant that a quantum computer could solve problems that a classical computer, whatever its design, never could. Factorising a number with 400 digits, for example, would occupy a modern supercomputer for the lifespan of the universe; but a quantum computer could, according to one estimate, do it in about a year. It would also be better at hunting for solutions to mathematical tangles such as the travelling-salesman problem (determining the shortest itinerary to visit several cities). Such problems, which quickly become intractable using conventional computers, have an annoying tendency to crop up in real-world situations involving scheduling and routing.

Gently does it

Building a quantum computer is one of physics' greatest challenges, because directly manipulating the quantum properties of particles such as electrons or photons also destroys their delicate state of superposition. A quantum computer must be isolated from the rest of the world in order to protect its fragile state, but it cannot be totally isolated, because then it will be impossible to get information in and out of it, and the computer will be useless. One way around this problem that has had some success uses the spins of atomic nuclei as qubits. Nuclear spins are robust because they are sheltered in the heart of an atom. And the technology for manipulating them is conveniently available off-the-shelf: nuclear-magnetic-resonance (NMR) spectroscopy, which relies on controlling nuclear spins to gain information on

molecular structures, has been in use in chemistry labs for years. Using this approach, a two-qubit quantum computer, in liquid form, was built in 1997.

A liquid-NMR quantum computer consists of many trillions of copies of a particular molecule. Each qubit is represented by a particular atom in every molecule, and all of the trillions of atoms corresponding to a particular qubit are manipulated at the same time. To make a two-qubit computer, the spins of two atoms in every molecule must be controlled; to make a three-qubit computer, three must be controlled, and so on. In the last four years, liquid-NMR quantum computers have grown steadily in size (a seven-qubit device was completed last year) and in ability. Last month, a team led by David Cory and Seth Lloyd of the Massachusetts Institute of Technology reported in *Physical Review Letters* that a three-qubit device of this type can perform a type of mathematical trick known as a Quantum Fourier Transform, a necessary step in the program for factorising large numbers on a quantum computer.

Unfortunately, the liquid-NMR approach will not work on a large scale. As a molecule grows in size, its NMR signature becomes more difficult to read and the signal rapidly becomes too faint to detect. Most researchers believe that given the current sensitivity of this technology, liquid-NMR quantum computing will not really be feasible beyond a ten-qubit limit.

So Dr Cory, along with Timothy Havel of Harvard and Raymond LaFlamme and Emanuel Knill of Los Alamos National Laboratories, is embarking on a project to use NMR in a solid. The idea is to use magnetic fields to control the spin of individual electrons. Since each electron has a powerful effect on neighbouring atomic nuclei—just as a large magnet has a powerful effect on small magnets nearby—the nuclear spins of nearby atoms can thus, they hope, be manipulated indirectly. Moreover, in the cooled crystal lattice that the researchers plan to use, these nuclear spins will not be upset by the vibrations of neighbouring molecules, as they would be in a liquid.

In theory, all this should make nuclear spins easier to detect and play with. The researchers believe that a solid-state NMR device could reach 20 or 30 qubits in the next three years. Such a computer would exceed the power of today's fastest supercomputers for certain types of simulation. Dr Cory's group is not alone—four or five other ideas have been proposed to push quantum computers into the tens-of-qubits range.

But a 20- or 30-qubit machine is still a far cry from what will be required to crack such grand problems as factorising 400-digit numbers. For each spectacular claim about quantum computing, there is an equally daunting problem that shows how remote those prospects are. Error correction, for example, is a big headache. In order for a quantum computer to be reliable, its error rate—the proportion of times a spin is manipulated wrongly—needs to drop to about one in a million. Today's devices are deemed to be doing well if their error rate is smaller than one in a hundred.

Correcting errors requires a large increase in the number of qubits. Dr Cory says that the program for factorising large numbers will require about 1,000 qubits simply to store the problem. But each of these qubits will require dozens of extra qubits for error-checking. That means that a useful computer will need tens of thousands of qubits to come up with a reliable answer. At seven and counting, that goal is a long way off.

On the other hand, the progress already made is remarkable. For conventional computers, Moore's Law states that processing power doubles roughly every 18 months. Since each additional qubit doubles the power of a quantum computer, quantum devices need grow by only one qubit a year to outpace the chip industry. Quantum computing has far exceeded this rate. In 1998, a three-qubit device had been developed; two years later, the number was seven.

A quantum leap of faith

Still, a machine with tens of thousands of qubits will require a lot more work. In America, government funding of quantum-computer research grew from $1m in 1995 to $30m last year. European and Japanese funding is on the rise too. A journal dedicated to the field, *Quantum Information and Computing*, will be launched this summer. There is even a company in New York, MagiQ Technologies, that has vowed to bring quantum devices to market within a decade. Given the combination of money, interest and people, says Dr Knill, "quantum computers must eventually work."

While optimists compare the state of the field to that of computing before the invention of the vacuum tube, sceptics place quantum computing somewhere between artificial intelligence and cold fusion: that

is, a venture that is at worst utterly wrongheaded and at best a waste of valuable research funds. The truth, as with most results in quantum physics, is probably a superposition of these two views. A more apt analogy may be between quantum computing and hot fusion: the physics certainly works, but it is difficult to harness this power for practical use.

Indeed, according to David Deutsch, a theoretical physicist at Oxford University and a pioneer of the theory of quantum computing, the most important application of quantum computers for the next decade or so will probably be inside the physics laboratory, to simulate quantum-mechanical systems. He says even theoretical quantum computing could help scientists better understand the quantum world. So even if it fails to provide a way out of computing's blind alleys, quantum computing should at least end up as a fruitful branch of physics.

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Orang-utans on the brink

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ALTHOUGH the world is home to tens of millions of animal species, the vast majority are small crawling things with lots of legs. When they are threatened, it is difficult for conservationists to stir up much public sympathy. Not so for the big, cute and cuddly animals known as “charismatic megafauna”. People will go to enormous lengths to protect them, their habitats and the other less attractive (but no less important) animals that live with them.

The red, furry orang-utan, found mainly in Indonesia, is undeniably one of the most charismatic of such megafauna. But this seems to be helping it less than you might suppose. According to the Zoological Society of London, the number of orang-utans has halved over the last decade to just 25,000. The main threat to Asia’s only great ape is illegal logging, which destroys the orang-utans’ habitats.

The root of the problem lies in Indonesia’s political turmoil, according to the Environmental Investigation Agency (EIA), an environmental group that has been scrutinising illegal logging in Indonesia for the past two years. The resulting power vacuum has allowed illegal timber extraction—an activity which already outstrips legal production—to move large commercial operations into supposedly protected parks such as Tanjung Puting National Park in central Kalimantan. There are only seven areas where orang-utans have populations of more than 1,000 individuals. Five of these, including three parks, are now being commercially logged.

Logging, both legal and illegal, used to be centrally controlled under the corrupt and nepotistic Suharto regime but is now in the hands of powerful regional timber barons who encourage local lawlessness. The EIA says that unless these people are prosecuted the future for the orang-utan looks bleak. According to a study by Carel van Schaik of the Wildlife Conservation Society, just published in the journal *Oryx*, the orang-utan faces extinction in the wild within ten years.

The main attraction of national parks such as Tanjung Puting for illegal loggers is a valuable decorative hardwood called ramin. The logging gangs working the forest are paid $1-2 per cubic metre to extract it. But when processed and carved into mouldings, ramin can fetch $1,000 per cubic metre. It is then exported to Europe (mainly Italy), America, Japan and China. As most legally obtainable ramin has already been felled, the only source is now inside protected areas.

The EIA has been investigating and exposing environmental crimes for the last 15 years, in areas such as trade in endangered species, the supply of illegal chemicals and illegal logging. Its main tool is to expose the leading figures perpetrating environmental crimes. But in Indonesia the EIA has a problem. The leading figures behind the logging are already well known, as are the illegal sawmills. The secretary-general of the forestry department has published the names of 18 regional timber barons who run Indonesia’s logging operations. So far, three of them have been arrested, one in the last month.

But Julian Newman, a senior investigator for the EIA, told a meeting of the Zoological Society this week that he is not optimistic about the outlook for the Tanjung Puting park. The man the EIA is accusing of being the region’s timber baron is a wealthy politician called Abdul Rasyid. EIA investigators and a local group called Telepak, posing as timber buyers, have compiled and published information on Mr Rasyid’s company, Tanjung Lingga. The attention of both Indonesia’s president, Abdurrahman Wahid, and agencies such as the World Bank and the IMF has been drawn to the plight of the park. But no action has been taken.

If the EIA’s claims are correct, that is a pity, but not surprising. Indonesia is riven with political and economic problems, and its legal system is dysfunctional. As a result, the fate of the orang-utan, officially declared an endangered species last October, has an ominously low priority.

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Power lines and cancer

Current concerns

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BACK in the 18th century, magnetism was all the rage for treating a wide variety of ailments. Today, however, the rage is mainly confined to those who feel that electromagnetic fields (EMF)—particularly those emitted by overhead power lines—are the cause of their dread diseases.

For the past 20 years, scientists have been investigating a possible link between rare ailments, such as childhood leukaemia and certain adult cancers, and exposure to EMF, either through living at close quarters to electricity lines or working alongside them at electrical utilities. Several large studies carried out in Scandinavia, America, Canada and Britain have, on the whole, concluded that there is little risk of cancer associated with EMF exposure. But shortcomings in some of their methods, and a lack of agreement between their results, has kept the debate electrified.

This week, a group of British researchers advising the government's National Radiological Protection Board weighed in with their assessment of the dangers of EMF. Having trawled through hundreds of epidemiological and laboratory studies published on the subject and taken into account their various flaws and biases, the advisory group agreed with the prevailing view that the association between EMF exposure and human cancer is weak. Its members found little convincing evidence of a connection between the sort of heavy-duty occupational exposure which, say, an engineer at an electrical substation might experience and either adult leukaemia or brain cancer. The advisory group did note, however, that prolonged residential exposure to relatively strong magnetic fields of greater than 0.4 microteslas is associated with a doubling of the risk of a child developing leukaemia.

This might sound alarming on the surface, but is less frightening in the detail. The British study estimates that around 300,000 people (0.5% of the country's population) are exposed to magnetic fields with a strength of 0.4 microteslas or more. (Background field-strengths in most British homes range from a fortieth to a half of this level, with occasional brief surges due to electrical appliances such as shavers and blenders.) So quite a few British children fall into this risk category. But childhood leukaemia is an uncommon ailment in the first place, with 500 cases reported each year in Britain. The researchers estimate that exposure to strong magnetic fields might be associated with an additional two cases of leukaemia a year.

But Anthony Swerdlow, an epidemiologist at the Institute for Cancer Research in London and a member of the advisory group, is quick to point out that even if EMF is associated with childhood leukaemia, that does not mean that it causes it. Laboratory testing, using isolated cells or experimental animals, has failed to show much of an effect on biological processes by the sort of EMF that might come from electrical supply lines. And since it is known that EMF does not directly alter DNA, one of the key steps in causing cancer, researchers are hard-pressed to come up with a plausible mechanism as to how such fields might cause trouble.

It is possible that EMF acts in conjunction with another agent which causes cancer, but this is hard to pin down in population-based studies since there are countless suspects lurking in the real world. It might be easier to expose such a carcinogenic conspiracy in the laboratory, but there are few adequate animal models of childhood leukaemia yet available to test the hypothesis.

In any case, this latest report on EMF and cancer is unlikely to be the final word on the subject. The researchers themselves call for additional studies on cells and animals. And while there are too few people in the high-exposure category in Britain to do further useful epidemiological studies, the group does recommend more population-based work, using the best techniques available, in other countries with higher exposures. Researchers also want to address the curious finding that four-fifths of the children in the high-EMF exposure category in Britain do not live near overhead power lines. The source of their EMF exposure, whether from household wiring or other causes, will need further investigation.

The bottom line, as Dr Swerdlow points out, is that exposure to EMF is linked to a modestly elevated risk

of a very rare disease in a small section of the population. Unfortunately, this is unlikely to quieten public fears of widespread danger from electricity lines. Childhood leukaemia is a cruel disease, and parents are naturally keen to find the cause. Blaming menacing electrical pylons and invisible, malign radiation is understandably easier than accepting the fact that science does not yet know what triggers this affliction in some children. In an age which expects iron-clad scientific solutions, living with uncertainty, however small the danger, is no easy thing.

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Burgeoning books

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Publishers can be as energetic as farmers in forecasting the demise of their business. Not so, says one publishing veteran, in a surprising memoir

BOOK BUSINESS: PUBLISHING PAST, PRESENT AND FUTURE
By Jason Epstein

Norton; 214 pages; $21.95 and £16.95

Buy it at
Amazon.com
Amazon.co.uk

Get article background

"IS PUBLISHING dead?" When the *Los Angeles Times* asked this deliberately leading (and not entirely original) question for a special issue of its weekly book review last month, 35 of America's most experienced publishers, editors, literary agents and booksellers took the trouble to reply. Their answers were quite surprising.

No one would deny that the industry has been through turbulent times in the past decade. The *Times* cited the continuing merger mania that has thinned the ranks of independent publishers and booksellers, the fixation that publishers have with name-brand authors who appear to guarantee immediate profits as against slower-selling but more enduring writers, and the industry's near-universal enrolment in the cults of celebrity, sensationalism and gossip. It asked whether publishers can still successfully—and profitably—bring out "difficult yet important" works of civic distinction and literary merit. And whether the industry can meet the challenge presented by the virtual world with its digital technology which is already altering traditional ways of both manufacturing and selling books, and perhaps, one day, the habit of reading itself.

Rejecting the notion—advanced most vigorously by André Schiffrin, former managing director of Pantheon Books, last year in "The Business of Books" (Verso)—that theirs is a dying profession, many of the respondents (though not Mr Schiffrin) announced that, despite its woes, publishing is very much alive. Indeed, far from being finished, some insisted, the book trade faces a future in which it is likely to flourish as never before.

Count among the optimists Jason Epstein. Both in his response to the questionnaire by the *Times* and in his incisive and elegant new book, Mr Epstein, one of America's most seasoned book editors, declares his faith in the electronic revolution. He is greatly encouraged by the spectre of what he calls the "machinery that can scan, digitise, and store permanently virtually any text ever created." He likes the fact that it allows other machines "to retrieve this content and reproduce copies on demand instantly anywhere in the world, either in electronic form, downloaded for a fee onto an e-book or printed and bound for a few dollars a copy, indistinguishable in appearance from conventionally manufactured paperbacks." The possibility of eliminating the publisher's fixed costs—the physical warehousing and distribution of books—would, he argues, make more perfect the relation between supply and demand, between author and reader.

Indeed, he suggests, it would enhance the democratic prospect. Mr Epstein envisions a world in which "machines that can print and bind single copies of texts will eventually be household items, like fax machines today." He predicts that "readers in Ulan Bator, Samoa, and Nome will have the same access to

books as readers in Berkeley and Cambridge. No book need ever go out of print."

Is Mr Epstein to be taken seriously? Or is he, like Marshall McLuhan, a manic exaggerator? Mr Epstein is, to be sure, a man of many accomplishments: the creation in 1952 of Anchor Books, which sparked the so-called quality trade paperback revolution; the co-founding in 1963 of the *New York Review of Books*; and in 1979 the establishment of the Library of America, the prestigious home of American classics (an idea originally suggested to him by Edmund Wilson). With that record, in addition to his day job over four decades as one of Random House's most gifted editors—publishing such authors as Norman Mailer, Gore Vidal, Jane Jacobs and Paul Kennedy—Mr Epstein's Delphic pronouncements carry considerable weight.

The curious thing about Mr Epstein's book is its unexpected optimism. Mr Epstein is a man widely known for his gloomy outlook and, indeed, for his devotion to authors, like Mr Kennedy, who predict the decline and fall of just about everything. In Mr Epstein's view, life usually goes from bad to worse. His is a temperament that is usually more common among Europeans than Americans. In "Book Business", Mr Epstein reveals himself instead as the sunniest of Americans, devoted to the idea of a technological fix to a cultural predicament. A model of intellectual rigour and sobriety, Mr Epstein uncharacteristically permits himself in this book a certain breathless prose. But perhaps he is to be forgiven, for his slim volume is as much elegy as it is prophecy.

He casts a fond look backward at his early days in publishing, when the profession was a cottage industry dominated by the idiosyncratic literary sensibilities of independently wealthy publishers, usually heirs to family fortunes whose businesses they chose not to pursue.Today, of course, all that is gone as one company after another has succumbed to the great corporate juggernaut whose titans endlessly strive for "synergy". It is a strategy doomed to failure. As Mr Epstein points out, book publishing was never destined to be a very profitable enterprise, dependent as it was on the fickle tastes of a public whose cultural proclivities could never be calculated in a way that would gladden an accountant's heart. "A cottage industry within an industrial conglomerate makes no sense," he writes. But, thanks to the Internet, publishing will, he predicts, become once again a cottage industry in which editors can edit, writers write, and the greatest task will be to cut through the noise of the culture and gain the attention of readers for whom story-telling will remain as indispensable to the human condition as it ever was.

Perhaps. Mr Epstein's view brings to mind Arthur Koestler, the author of "Darkness at Noon" who, when asked to choose between 100 readers in the present and ten readers a century hence, replied unhesitatingly, "Why, ten readers 100 years from now, of course." He then paused, and said with a smile, "But I suppose such sentiment gives no comfort to my publisher, who hopes still to be in business in 100 years."

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Wordwombs

Mar 8th 2001
From The Economist print edition

AP

Start'em young

THE common lament about the dumbing-down of modern society is flatly contradicted by the vitality of reading groups on both sides of the Atlantic. As many as 50,000 people belong to such clubs in Britain. In America the figure may be ten times larger, according to Jenny Hartley, a lecturer at the University of Surrey. Ms Hartley was so intrigued by this cultural phenomenon that she set out to survey 350 groups in Britain, America and elsewhere to find out more. "Reading Groups" (OUP; $9.95 and £5.99) is the result.

The recent growth in reading groups has been partly due to promotion by the mass media. In 1996, Oprah Winfrey, an American talk-show host, launched her "Oprah's Book Club". As Ms Hartley says, it quickly became "one of the most staggering phenomena in the history of collective reading". Each month Oprah chooses one book; by the time it is discussed on the show the following month, 500,000 viewers have read at least part of it. So far, Oprah can claim responsibility for 28 bestsellers.

In Britain the reading-group idea got a boost in 1997 when Orange, then still a smallish mobile-phone company that also presented a yearly prize for women's fiction, launched a book promotion. A year later the *Mail on Sunday*, a mid-market newspaper, launched its own monthly reading-group promotion. The newspaper offered readers 5,000 reading-group starter packs, which were eagerly snapped up.

The recent proliferation of groups is reflected in Ms Hartley's survey figures: 38% are less than two years old. But she also shows that reading groups have been around for a very long time; some British groups have a continuous history going back over 200 years. The Dalton Book Club in Cumbria was started by 17 men in 1764; and when a man has been a member for 50 years, he has to buy a bottle of brandy for the club. Over the years, eight members have had to reach into their pockets.

Many of the oldest groups, like those in Dalton, Stockton and Bristol, were all-male affairs, but today it is women who dominate. In Ms Hartley's survey, 69% of groups are all-female and 27% are mixed: only 4% are all-male. "Our husbands don't read very much" and "women take more pleasure in verbalising their feelings" are just two examples of the responses she was given when she asked why it was that all-female groups dominate.

Most reading groups focus on modern fiction, especially recent fiction. Among the most popular books are Louis de Bernières's "Captain Corelli's Mandolin" and Frank McCourt's "Angela's Ashes". But many groups range more widely, and some are rather specialised. One group at London University focuses on James Joyce's "Ulysses", and in 14 years has read five chapters. Another in San Francisco, the "Marcel Proust Support Group" just reads the French master and tries to get through ten pages a day of "Remembrance of Things Past". But book groups, of course, are not just about books. Food and drink, not surprisingly, play an important part. And as the novelist Margaret Atwood has observed: "The real, hidden subject of a book group discussion is the book group members themselves."

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Milosevic of Serbia

Mystery man

Mar 8th 2001
From The Economist print edition

OCTOBER 5TH: A 24-HOUR COUP.
By Dragan Bujosevic and Ivan Radovanovic.
Media Center Belgrade; 318 pages; 600 dinars and DM20

SERPENT IN THE BOSOM: THE RISE AND FALL OF SLOBODAN MILOSEVIC
By Lenard J. Cohen

Westview; 496 pages; $35 and £24.99.

Buy it at
Amazon.com
Amazon.co.uk

AT A raucous society wedding in Belgrade last summer, Serbia's most famous gypsy band played until late, the bride and groom danced on the table and the moon glistened below on the waters of the Danube. Out on the restaurant terrace, members of the Serbian elite laughed, clinked champagne glasses and asked each other what was likely to happen when President Slobodan Milosevic, as everyone expected, introduced restrictive new laws. The guests included known enemies of Mr Milosevic as well as loyal apparatchiks and even one-time close advisers. What they all had in common was their ignorance of what he would do next.

For ten years, Mr Milosevic had kept the politicians and diplomats of Belgrade guessing. Nobody really knew what was in his mind. And this uncertainty was at least part of why he stayed in power so long, despite driving his country from one calamity to another. Last July, he finally miscalculated, proposing a change to the constitution that would, in effect, have prolonged his dictatorship. He lost the ensuing elections and, after refusing to leave office for two weeks, gave up power on October 5th as hundreds of thousands of Serbs converged on Belgrade in protest.

If those nearest to Mr Milosevic never got his measure, what chance then for outsiders? Lenard Cohen, who teaches at a Canadian university, has a fair crack. Although his book is being sold as one, it is not a proper biography. Rather, it is a meticulous chronicle of the Milosevic years, concentrating on Kosovo, with little about the Bosnian or Croatian wars, which Mr Milosevic also provoked. Some readers may be put off by its dry style—it comes with graphs and charts—but as an academic study it is likely to stand the test of time.

If, as seems possible, Mr Milosevic ends up sooner or later answering charges by the International War Crimes Tribunal in The Hague, its prosecutor's office could do worse than place a bulk order for "Serpent in the Bosom". Its lawyers won't find incriminating secrets here—Mr Milosevic rarely committed orders to paper—but the book is packed with detail about the political manoeuvring over Kosovo .

By contrast, several so-called secrets come tumbling out of "October 5th", which two Belgrade journalists wrote quickly in the wake of Mr Milosevic's fall. One major police unit had already pledged its support to the opposition; other units decided to disobey orders; opposition leaders were in touch with key security officials; several groups were armed to the teeth, ready to do battle. And so on. Gripping, inside stuff, to be sure, but how illuminating is it?

After reading this book, for which more than 60 people were interviewed, it is still unclear what really happened. Was it a coup? Even the authors seem unsure: "The chair on which the regime sat was rotten," they write. "When the first leg was pulled out, everything fell down with a crash." Not surprisingly, one character is missing from this fascinating but confusing book: Mr Milosevic himself. When finally stripped of power, even knowledgeable Serbs were still mystified by what he was up to.

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Europe and America

Ménage à trois?

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From The Economist print edition

FANATICISM in politics is fraught with danger, but when writing books, it can serve as a useful spur. John Redwood is one of those British Eurosceptics who see everything through the prism of a noble Britain subverted by perfidious Brussels. Yet this lurid vision has drawn him nevertheless towards an important subject: the coming conflicts, as he puts it, between the USA and the European Union.

STARS AND STRIFE: THE COMING CONFLICTS BETWEEN THE USA AND THE EUROPEAN UNION.
By John Redwood

Palgrave; 202 pages; $39.95 (June) and £35 (Ã‚Â£12.99 paperback)

Buy it at
Amazon.com
Amazon.co.uk

That said, too little of "Stars and Strife" is devoted to its stated topic. Rather than examining in detail the United States' relations with Europe, he prefers to moan about how Britain joined one sort of Europe only to discover that its partners were hell-bent on creating another. The main argument of the book is that liberal, free-trading, Yankophile Britain cannot remain enthusiastically part of a federal, Yankophobic, protectionist Union. Rather than leaving the Common Market, it should renegotiate its membership, securing a more permanent "opt-out" from all sorts of EU things (including taxes and armies) and a much lower budget contribution; and balance it by seeking to join the North Atlantic Free-Trade Agreement (NAFTA).

There is inevitably a great deal of Euro-teasing, some of it lighthearted in a provincial way (he notices British cappuccino-drinkers shivering in street cafes, "because that is how the Italians do it"); some of it crude (it takes him only a few pages to bring up a gratuitous reference to French collaboration with the Nazis during the second world war). Although Mr Redwood, a fellow of All Souls college in Oxford and a Tory MP, makes an effort to present Britain as caught between being the 51st state of the United States of America and the 15th state of the United States of Euroland, you sense that his heart is with the land of free enterprise and more limited government: "The Atlantic is 3,000 miles narrow, and the English Channel is 30 miles wide."

The more interesting bits of the book tend to be thrown in almost as incidental facts dictating Britain's momentous choice. Mr Redwood assembles much information about the friction between America and Europe. Without the cold-war glue that bound it to America, Europe, he argues, is increasingly trying to challenge America—on trade, in military affairs, in environmental affairs, at the UN. And Europe's sense of distance, he believes, is not just a matter of economic self-confidence but of cultural snobbery. For many continental sophisticates, America, with its guns, its executions, its mindless television, its slavish devotion to the market, has become a cultural Antichrist.

Mr Redwood's description of a growing gulf is excessive. For all their cultural self-assertion, the French drink plenty of Coca-Cola and eat a lot of Big Macs. There are also many British people who probably share their Euro-neighbours' worries about American violence and junk culture. And, like many Thatcherites, he exaggerates America's interest in Britain for its own sake (as opposed to Britain as simply the most amenable and poodlelike bit of the EU). In his last speech before leaving office this week, the American ambassador went out of his way to stress his country's interest in Britain remaining at the core of Europe.

But Mr Redwood also puts his finger on legitimate, liberal worries about the EU. For him, the Union is fundamentally an old-world structure—originating in old industries (coal, iron, steel and food) and old ideas involving huge regulatory institutions. By contrast, NAFTA is a more modern, flexible, open affair. This is a caricature. But all caricature exaggerates genuine traits. He points out that membership of the European Union prohibits Britain from becoming part of NAFTA, though membership of NAFTA does not prevent joining other free-trade pacts. A fanatic's comparison perhaps (few Americans take the idea of Britain joining NAFTA seriously), but one we are unlikely to have heard the last of.

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Reclaimed land

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A ruined dock in Piran, Slovenia, converted into a handsome town square, is one example of “winning back city space” from 39 sites in Europe, America and Japan, examined by Jan Gehl and Lars Gemzoe in “New City Spaces” (Danish Architectural Press; 264 pages; eksp@arkfo.dk)

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Last rites

Burning ideas

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From The Economist print edition

SUPPOSING you are on the brink of death and, being a dutiful human being, have sought to put your worldly affairs in order, paying off your credit cards and so on. A lingering concern occupies your last thoughts. Should you proceed to the next world in some style, your cortège dignified by, say, six white horses? Or would it be more responsible to depart the modern way, at least saving your dearest some money, by leaving instructions for your body to be burnt?

PURIFIED BY FIRE: A HISTORY OF CREMATION IN AMERICA. By Stephen Prothero.

University of California Press; 280 pages; $27.50 and £18.50

Buy it at
Amazon.com
Amazon.co.uk

In Britain, it seems, most people have long made up their mind in favour of cremation. About 70% of bodies are burnt. In the United States, though, the proportion is only some 25%. Stephen Prothero appears to have discovered a rare area of technological progress in which the Americans are lagging behind.

The cremationists have had a hard task persuading Americans that theirs is the proper, hygienic and indeed American way of disposing of the body. It is argued that the loved one's relations are spared trips to the graveyard on a cold damp day. What could be nicer than keeping your husband's ashes in a tasteful box on the mantelpiece? Or consider a fear—primitive and foolish, no doubt, yet still persistent—that haunts those who opt for the grave: being mistakenly buried alive as the result of a doctor's blunder, waking up six feet under and desperate to get out. Better by far a quick end through cremation.

But in the profitable industry of the disposal of the dead, the traditionalists have fought in America to keep their market share. To impress the dying, early crematoriums—given the name of "columbariums" for a place to store ashes—were built with the grandeur of cathedrals. In response, the traditionalists have replaced drab urban burial grounds with pleasant lawn parks. Lobbyists for the burial industry have persuaded the American government not to take sides, unlike in places short of land, such as Japan and European countries, where governments have encouraged the spread of crematoriums.

Sadly, the cremationists who were anxious to show the social advantages of their mission have sometimes overdone things. One American doctor pointed out that the ashes of the dead make excellent fertiliser. Ever the utilitarian, the same man suggested that the dead could make themselves especially useful by having their skins removed before incineration and turned into leather.

The public was not enthusiastic. The story of cremation in America, Mr Prothero notes, is one of only moderate success. But the cremationists have never stopped trying, even if some of their efforts verge on the fantastic. In 1997 the cremated remains of 24 people, among them Gene Roddenberry, the creator of "Star Trek", were rocketed into orbit. Their fond relations could have the solace of knowing that they were passing heavenwards every 90 minutes. Forget white horses. For the corpse who has everything, this was the only way to go.

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British fiction

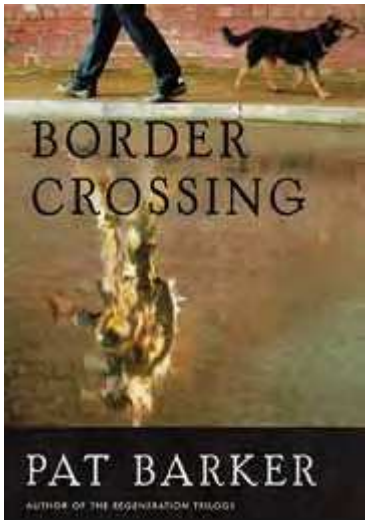
The easy way out

Mar 8th 2001
From The Economist print edition

BORDER CROSSING
By Pat Barker

Farrar, Straus and Giroux; 224 pages; $22.
Viking; £16.99

Buy it at
Amazon.com
Amazon.co.uk



THE story is straightforward and timely. Tom is a psychiatrist who works with disturbed children. He is in the middle of separating from his wife. Years ago he gave evidence which helped to convict a child who had murdered. Now the murderer—if he really was a murderer—reappears in Tom's life and causes him to confront large questions about the nature of evil, the existence of original sin, and whether counselling is beneficial or destructive. Tom is also forced to examine his own capacity for evil.

This would seem a good framework within which to address a variety of contemporary dilemmas. Unfortunately, Pat Barker is more concerned with the dilemmas than with the story, and the result is formulaic.

An earlier work with which "Border Crossing" bears immediate comparison is Peter Shaffer's intriguing play, "Equus", which also centres on the confrontations between a child and a psychiatrist. In "Equus" these scenes crackle with tension, offering superb opportunities for the actors. In "Border Crossing" things are more predictable, and the mutual self-knowledge which results comes too easily. Wickedness is extreme. It is possible to log on to Internet sites and watch dismembered babies being eaten. To confront evil is to lay yourself open to truths about yourself which may not just be unpalatable but impossible to live with.

Ms Barker made her reputation with the powerful "Regeneration" trilogy, about the lasting effects of the first world war. Yet in "Border Crossing" both her dialogue and her descriptive writing lack the vividness which made those earlier novels so compelling. Here she is too polite for her material, too willing to take the easy way out.

At the end of the novel, the crises of Tom's loneliness and the boy's redemption are resolved together. But you are left with the feeling that the central characters are less living and breathing human beings than composites of attitudes. The boy is intelligent, manipulative and inclined to set light to things. He had a violent father and an inadequate mother, but he is kind to kittens. He is a paradigm, a case study, as much as a boy. Ms Barker's admirably liberal instincts have deflated what might otherwise have been a potent investigation into the nightmare of evil. "Border Crossing" is certainly engrossing. But there is too much cosiness, too much correctness, too little pain.

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Architecture and cities

Imagining Metropolis

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From The Economist print edition

Four current museum shows focus on different aspects of the modern city

WHY—indeed whether—great art and great architecture flourish together in particular cities at particular times is obviously a topical question. A sprawling show at Tate Modern on London's Bankside asks us to view nine cities as seedbeds of 20th-century art. A second, more focused show in Los Angeles presents architects' visions of the city itself as a work of art. A third exhibition, also in Los Angeles, shows how a little-known European modernist put his mark on that most American of cities. And a fourth, forward-looking show in Montreal offers us daringly imaginative ways to transform public spaces.

Iwona Blazwick, who mounted the Tate show, invited her curators to "map" modern art in Paris (1905-15), Vienna (1908-18), Moscow (1916-30), Rio de Janeiro (1950-64), Lagos (1955-70), Tokyo (1967-73) and New York (1969-74), as well as London and Mumbai in the 1990s. Her view of the modern city as a "creative crucible" naturally works better in some places than others. Certainly, it suits revolutionary Moscow, where Vladimir Mayakovsky declared: "The streets shall be our brushes—the squares our palettes!"

Thanks to a compelling display by Lutz Becker, a curator and film maker, you walk into the great red hope of the Bolshevik revolution. Films, posters and architectural maquettes present the new Soviet capital exploding with the hopeful idea that art and architecture can remake the world. The work of Alexander Rodchenko and El Lissitsky is breathtaking. But, like Vladimir Tatlin's magnificent, wholly impractical glider hovering above, the Utopian vision of the Russian avant-garde was too frail for the real world.

As in any whirlwind trip, the eye catches flashes of beauty—dazzling work from *bossa nova* Brazil, for example. The Vienna section's red room displays a staggering array of nudes by Egon Schiele, with Sigmund Freud's consulting couch (borrowed from London's Freud museum) installed at the end like an altar. But all in all, "Century City" is over-ambitious and overgrown. As the inaugural show for Tate Modern—and the Tate's most expensive show ever—it proves especially disappointing. Strangest of all, architecture is a virtual no-show, apart from a few nods to the Vienna Secession and the urban visions of Otto Wagner and Josef Loos. Despite its claim to anchor art in a place, the architectural experience of being immersed in a city is what "Century City" sadly lacks.

Wagner's architecture, by contrast, is the presiding spirit of "Shaping the Great City", now at the Getty Museum in Los Angeles. Its theme is Wagner's part in the spread of the idea of the metropolis. He asked big questions about how we should think about and shape the modern city. To him, a city was a cultural artefact which should be treated as a unified space, with clear perspectives and uniform building styles. Interestingly, a fellow Viennese architect, Camillo Sitte, shared Wagner's conception of the city as an aesthetic unity but took an opposite view about what it should look like. In his plans for Marienburg and other towns, Sitte tried to reproduce the diversity of medieval and baroque cities as the ideal way to incorporate the different functions of urban life. Neither architect's urban plan was realised, although Wagner's Post Office Savings Bank in Vienna remains a landmark.

Looking down from the Getty on to the hazy sprawl of Los Angeles—hated by some, celebrated by others—visitors are bound to wonder if such heroic European urbanism can possibly be relevant today. But it is, insists Wim de Wit, a Getty researcher. He cites, in evidence, two contemporary public buildings that, it is hoped, will revive dismal Los Angeles spaces—Frank Gehry's Disney Hall and Rafael Moneo's cathedral—as well as a great 20th-century architect, R.M. Schindler. A pupil of Wagner and Frank Lloyd Wright, Schindler settled in Los Angeles and planted there the seed of European modernism. Much of what we think of as typically southern Californian—the Lovell beach house at Newport Beach, for example—is due to him. Coincidentally, a fine show of Schindler's work can be seen at the Museum of Contemporary Art in Los Angeles.

For every Schindler house, it is true, Los Angeles has four dozen malls and 300 miles of urban strip. We

are all used by now to the gap between modernism's hopes and achievements—none more than Phyllis Lambert, founder and director of the Canadian Centre for Architecture (CCA). But there is nothing wistful or nostalgic in her defence of modern design. She likes to quote Mies van der Rohe, whom—as daughter of the firm's boss—she commissioned to design the Seagram Building (1959) in New York: "You don't have cities any more, only jungles. The key for an architect is how you make a clearing in the jungle."

That was the thinking behind the CCA's new $100,000 prize for urban design, awarded last year to Peter Eisenman, an experimental New York architect. Mr Eisenman won with a design for a rooftop park above Manhattan from Madison Square Garden to the Hudson river. His plan, along with those of the other finalists, is on show at the CCA. It is tempting, perhaps, to treat these designs also as Utopian visions. Yet work like this sets out in three-dimensional models a simple but easily neglected truth: we cannot improve cities unless we look at them carefully—and then imagine how they might be.

"Century City". Tate Modern, London; to April 29th.

"Shaping the Great City: Modern Architecture in Central Europe 1890-1937". Getty Museum, Los Angeles; to May 6th. Kunstforum, Vienna; June 14th-August 26th.

"The Architecture of R.M. Schindler". Museum of Contemporary Art, Los Angeles; to June 3rd.

"New York: CCA Competition for the Design of Cities". Canadian Centre for Architecture, Montreal; to April 1st.

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Media wars

Screen stories

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JUST over two decades after CNN burst on to the airwaves, the 24-hour news network is in trouble. What was once a gutsy, entrepreneurial business is now just another division of the giant AOL Time Warner conglomerate. Faced with declining popularity, sagging morale and stiff competition from imitators like MSNBC and Fox News Network, it recently laid off a tenth of its staff.

ME AND TED AGAINST THE WORLD: THE UNAUTHORIZED STORY OF THE FOUNDING OF CNN
By Reese Schonfeld

Cliff Street Books/HarperCollins; 407 pages; $26

Buy it at
Amazon.com
Amazon.co.uk

"Me and Ted Against the World" harks back to CNN's salad days, when it dared to upset the established networks, hired college kids as news producers and staggered from one financial crisis to another. Reese Schonfeld, CNN's co-founder alongside Ted Turner and its first president and CEO, conveys not only the early excitement, but also a sense of how far CNN has strayed from its initial promise. The network that revolutionised television news reporting is today "sluggish and constipated"—a decline that is reflected not only by sliding ratings but also in its 2000 election coverage, which was described as "a debacle" in an independent report. As Mr Schonfeld puts it: "CNN has become worldwide and skin-deep. Its coverage splashes over everything and saturates nothing."

Unfortunately, this criticism is marred by a severe case of sour grapes. The author, who was fired by Mr Turner in 1982, is out for revenge—not least, one suspects, because he rarely gets much public credit for his role (at CNN's 20th anniversary party his name was misspelled on his ID badge). This makes for some amusing anecdotes, like the time that Mr Turner returned from a duck shooting trip with the Cuban president to announce: "Fidel ain't a communist. He's a dictator just like me." But it also undermines the book's attempt at serious analysis. Mr Schonfeld's contention, that CNN's decline dates from his own dismissal, even though this was years before the network's finest moment—its Gulf war coverage—deserves little airtime.

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Harold Stassen

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Harold Stassen, the man who wanted to be president, died on March 4th, aged 93

AP

ON NINE occasions between 1948 and 1992 Harold Stassen tried without success to become president of the United States. His bids were not simply quixotic or to gain publicity for a cause: he was not a Green or a Libertarian or just having fun. He was an important politician in the Republican Party who believed it was his destiny to run America. It was only after his final try for the White House at the age of 85 that he was at last persuaded to call off his ambitions.

One of Mr Stassen's favourite remarks was "I tried." His surviving band of loyal followers wondered if it might be possible for Mr Stassen to be given some honour for trying, in the way that Hollywood grants a special Oscar to a film personality who seems to have been around for ever, but has never won anything. But politics is a crueller calling. America does not care for losers, even famous ones. Nothing came of the proposal, except an award by some jokers to Harold Stassen "for political futility". A newspaper cartoon showed his supporters meeting in a telephone kiosk.

Whenever Mr Stassen gave an interview, the reporter would usually start off by asking if he was hurt by jokes about his failed campaigns. Being human, as well as a politician, of course he was hurt. But the politician answered the question. He told of being introduced to an audience in Texas. The chairman said, "Believe it or not, he is still alive and here he is." Everyone laughed, and Harold Stassen offered the obligatory laugh as well. It was clearly no fun being a political curiosity. But you had to enjoy it, he said.

Although Mr Stassen wrote a number of books, among them a study of Eisenhower's years as president, he published little of a personal nature. Perhaps the idea of documenting the downward path of his long life was a mite too distressing. For if ever a person seemed from his early years to be marked out to be president it was Harold Stassen.

The "boy governor"

He was from Minnesota, the son of a farmer whose father had migrated from Norway. He was studying law at the local university at the age of 16, and at 23 won his first election, to head a county law department. At 31 Mr Stassen was elected governor of Minnesota, the youngest in any American state. Stories of the gifted "boy governor" reached the national bosses of the Republican Party, and in 1940 he was invited to give the opening, "keynote", speech to the party's convention. In the back rooms where political decisions were made, smoke-filled in those days, he was seen as the Republican to topple the hated Franklin Roosevelt. They might have chosen him there and then as their presidential candidate, except that he was not yet 35, the minimum age to be president.

In the second world war he served in the navy. His ship was twice hit by enemy fire and Mr Stassen returned a bemedalled hero to the political stage. Roosevelt had died in 1945 while still president and had been succeeded by Harry Truman, his vice-president. Now, in the 1948 contest, Truman was the Democratic candidate, and regarded by the Republicans as a pushover. Harold Stassen seemed the likely choice to do the pushing. But, in one of the quirks of politics, the Republicans chose the older Thomas Dewey who fought a lacklustre campaign and, against all predictions, lost to Truman. Mr Stassen prepared himself for another try as the next election approached, but the Republicans found themselves in possession of an unbeatable, gilt-edged candidate, Dwight Eisenhower.

Still, America's eternal candidate persisted in election after election. There remained the chance of being picked as a compromise candidate if the front-runners were deadlocked. This was theoretically possible, except that by now Mr Stassen had lost most of the appeal he might have had as a champion of

Republican ideas, and he never came closer to the presidency than he had in 1948.

He was never a conservative and had actually admired Roosevelt. He had helped to draft the charter of the United Nations which, as the cold war developed, many Americans believed favoured the Soviet Union. Some Republicans said he would be happier with the Democrats. Mr Stassen, always good-natured, agreed, but said he had decided to stay with the Republicans in the hope of liberalising them. Republican fears about him seemed to be confirmed when in 1956 Mr Stassen attacked Richard Nixon, then Eisenhower's vice-president. After that many people in the party shunned him, he said.

In his long life Harold Stassen did many useful things. During the Eisenhower administration he ran America's foreign-aid programme. He was in the cabinet as an adviser on disarmament, a pretty thankless job at the time, but "working for peace", he said later, was the best job he did. He was president of the University of Pennsylvania for seven years, and is remembered as an academic reformer. He was a partner in a successful law firm for more than 30 years and was married for 70 years. He was turning up at political meetings almost to the time of his death. In most ways it was a pretty fruitful life. Except that he wanted to be president.

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OUTPUT, DEMAND AND JOBS

Mar 8th 2001
From The Economist print edition

Australia's GDP fell by 0.6% in the fourth quarter; year-on-year growth slowed to 2.1%. The volume of retail sales in the euro area rose by 1.7% in the year to December, up from 1.2% in the year to November. Japan's jobless rate remained at a record 4.9% in January. Germany's rate was unchanged at 9.3% in February.

% change at annual rate	GDP		The Economist poll GDP forecasts		Industrial production		Retail sales (volume)	Unemployment % rate	
	3 mths†	1 year	2001	2002	3 mths†	1 year	1 year	latest	year ago
Australia	− 2.2	+ 2.1 Q4	+ 3.0	+ 4.0	− 1.5	+ 4.2 Q3	− 0.1 Q4	6.6 Jan	6.8
Austria	+ 1.2	+ 1.9 Q3	+ 2.4	+ 2.7	na	+ 2.2 Nov*	+ 1.1 Nov	3.3 Dec	3.6
Belgium	+ 4.9	+ 3.1 Q4	+ 2.7	+ 2.8	na	+ 7.3 Dec*	+ 6.4 Nov	10.7 Jan*	11.3
Britain	+ 1.0	+ 2.4 Q4	+ 2.5	+ 2.8	− 2.9	+ 0.5 Dec	+ 3.3 Jan	5.3 Dec‡	5.9
Canada	+ 2.6	+ 4.0 Q4	+ 2.6	+ 3.5	+ 1.8	+ 3.2 Dec	+ 4.6 Nov	6.9 Jan	6.8
Denmark	+ 2.0	+ 2.7 Q3	+ 2.0	+ 2.2	na	+ 4.3 Jan	− 1.0 Dec	5.4 Dec	5.4
France	+ 3.9	+ 2.8 Q4	+ 2.6	+ 2.9	+ 2.3	+ 2.9 Dec	− 1.5 Dec	9.0 Jan	10.5
Germany	+ 0.8	+ 1.9 Q4	+ 2.4	+ 2.8	+ 0.2	+ 4.9 Dec	− 2.9 Dec	9.3 Feb	10.1
Italy	+ 3.2	+ 2.7 Q4	+ 2.2	+ 2.6	+ 5.9	− 3.3 Dec	− 1.4 Dec	10.0 Oct	11.1
Japan	− 2.4	+ 0.5 Q3	+ 1.1	+ 1.7	− 4.1	+ 2.2 Jan	− 1.1 Dec	4.9 Jan	4.7
Netherlands	+ 5.1	+ 3.1 Q4	+ 3.1	+ 3.3	+ 8.5	+ 9.4 Dec	+ 2.9 Nov	2.6 Jan§	2.7
Spain	+ 2.9	+ 3.7 Q4	+ 3.1	+ 3.5	+ 0.1	+ 4.4 Dec	na	13.7 Dec	15.1
Sweden	+ 3.9	+ 4.0 Q3	+ 3.1	+ 3.3	na	+10.1 Dec	+ 3.7 Dec	4.4 Jan*	5.7
Switzerland	+ 1.8	+ 2.5 Q4	+ 2.2	+ 2.4	na	+ 6.9 Q3*	− 2.0 Dec	2.0 Jan*	2.6
United States	+ 1.1	+ 3.4 Q4	+ 1.6	+ 3.4	− 3.2	+ 2.4 Jan	+ 2.6 Dec	4.2 Jan	4.0
Euro area	+ 2.4	+ 3.3 Q3	+ 2.5	+ 2.9	+ 7.5	+ 8.0 Dec	+ 1.7 Dec	8.8 Jan	9.5
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*								
Finland	+ 3.0	+ 5.5 Q4	na	na	+17.2	+ 7.0 Dec	+ 3.6 Nov	9.9 Jan*	10.6
Greece	na	+ 2.5 2000	na	na	na	+ 3.1 Nov	+ 6.0 Nov	na	na
Iceland	na	+ 4.4 1999	na	na	na	+ 4.2 1999	na	1.3 Dec	1.7
Ireland	+21.5	+12.2 Q2	na	na	na	+19.7 Dec	+ 9.7 Nov	3.6 Feb	4.5
Luxembourg	na	+ 7.5 1999	na	na	na	+ 1.2 Nov*	+15.8 Sep	2.6 Dec	2.9
New Zealand	+ 2.7	+ 2.4 Q3	na	na	na	+11.5 Q3*	+ 7.3 Q4	5.6 Q4	6.3
Norway	+ 0.2	+ 0.9 Q4	na	na	+ 5.5	− 2.7 Dec	+ 0.7 Dec	3.1 Q4	3.2
Portugal	+ 0.8	+ 2.6 Q2	na	na	na	+ 6.2 Dec*	+ 3.9 Nov	3.8 Q4	4.1

*Not seasonally adjusted. †Average of latest 3 months compared with average of previous 3 months, at annual rate. ‡Oct-Dec; claimant count rate 3.5% in January. §Nov-Jan.

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COMMODITY PRICE INDEX

Mar 8th 2001
From The Economist print edition

Forecasters at the Canadian Wheat Board say world wheat stocks will fall to 109m tonnes by the end of July. By 2002, they could shrink to 85m tonnes—just 14.2% of annual world consumption, the lowest percentage for more than 40 years. This year's global wheat crop is expected to be the smallest in five years, at only 573m tonnes, but wheat prices have still been falling. This unusual combination of events has arisen because most of the stock reductions have been in Russia and China; supplies held by the bigger exporting countries have been sufficient to cover demand. But prices could soon rebound. America has planted its smallest acreage of winter wheat since 1972, and its crop accounts for a fifth of world trade.

1995=100	Feb 27th	Mar 6th*	% change on one month	% change on one year
Dollar index				
All items	70.5	71.9	+ 0.0	– 3.0
Food	69.8	71.4	+ 1.3	+ 1.0
Industrials				
All	71.6	72.6	– 1.5	– 7.8
Nfa†	64.6	64.9	– 2.7	– 12.2
Metals	77.5	79.1	– 0.7	– 4.5
Sterling index				
All items	77.1	77.3	– 0.4	+ 4.6
Food	76.3	76.7	+ 0.8	+ 8.9
Industrials	78.3	78.0	– 2.0	– 0.7
Euro index				
All items	101.0	101.6	+ 0.2	– 0.1
Food	99.9	100.9	+ 1.4	+ 4.0
Industrials	102.5	102.6	– 1.4	– 5.1
Yen index				
All items	87.2	90.9	+ 3.4	+ 8.0
Food	86.3	90.3	+ 4.7	+ 12.5
Industrials	88.5	91.8	+ 1.8	+ 2.6
Gold				
$ per oz	268.40	260.80	– 0.9	– 10.8
Crude oil North Sea Brent				
$ per barrel	25.96	26.60	– 6.9	– 15.7
West Texas Intermediate				
$ per barrel	28.23	28.49	– 5.8	– 15.6

* Provisional. † Non-food agriculturals.

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ECONOMIC FORECASTS

Mar 8th 2001
From The Economist print edition

Every month *The Economist* surveys a group of economic forecasters and calculates the average of their predictions for economic growth, inflation and current-account balances for 15 countries and the euro area. The table also shows the highest and lowest forecasts of growth. The previous month's forecasts, where different, are shown in brackets. Our panel's average prediction for growth in America's GDP during 2001 fell by 0.2 percentage points to 1.6%. Expectations of American inflation in 2001 dropped more sharply, from 3.4% to 2.6%. In addition, the average forecast for the current-account surplus in Canada, America's biggest trading partner, was cut from 1.3% to 0.6% of GDP for 2001. This month, for the first time, we show growth forecasts for 2002.

The Economist poll of forecasters, March averages (previous month's, if changed)

	Real GDP, % change Low/high range		Real GDP, % change average		Consumer prices % increase		Current account % of GDP	
	2001	2002	2001	2002	2001	2002	2001	2002
Australia	2.5/3.6	3.0/4.6	3.0 (3.2)	4.0	3.9 (4.1)	3.0	–3.4	–3.6
Austria	1.8/2.9	2.0/3.4	2.4	2.7	1.7	1.7	–2.4	–2.0
Belgium	2.2/3.1	2.0/3.8	2.7	2.8	2.0 (2.1)	1.9	4.2 (4.0)	4.2
Britain	2.1/2.9	2.3/3.3	2.5	2.8	2.2	2.5	–1.9 (–1.8)	–1.6
Canada	1.5/3.7	1.5/5.0	2.6 (2.8)	3.5	2.4	2.2	0.6	0.9
Denmark	1.5/2.4	1.9/2.6	2.0 (2.1)	2.2	2.3	2.3	1.4	1.4
France	2.3/2.9	2.3/3.3	2.6	2.9	1.4	1.5	1.9	1.9
Germany	1.8/2.8	2.3/3.1	2.4	2.8	1.7 (1.5)	1.5	–1.2 (–1.0)	–1.0
Italy	1.6/2.5	1.5/3.1	2.2	2.6	2.2 (2.1)	2.0	–0.2	–0.1
Japan	0.2/2.4	0.9/3.1	1.1 (1.4)	1.7	–0.4	–0.3	2.3 2.2	2.3
Netherlands	2.8/3.5	2.7/3.9	3.1 (3.0)	3.3	3.2 (3.0)	2.3	3.9 (4.0)	4.2
Spain	2.8/3.5	2.7/4.2	3.1	3.5	2.9	2.7	–3.1 (–3.0)	–3.1
Sweden	2.6/3.8	2.6/4.2	3.1 (3.2)	3.3	1.7	1.7	2.1	2.0
Switzerland	1.8/2.7	1.6/3.5	2.2	2.4	1.4	1.3	11.8 (11.7)	11.3
United States	nil/2.7	1.5/5.2	1.6 (1.8)	3.4	2.6 (2.5)	2.3	–4.3 (–4.2)	–3.9
Euro area	2.3/2.9	2.3/3.4	2.5 (2.6)	2.9	1.9	1.8	–0.2	–0.2

Sources: ABN Amro, Deutsche Bank, EIU, Goldman Sachs, HSBC Securities, IKBC Bank, Merrill Lynch, J.P. Morgan, Morgan Stanley Dean Witter, Nordbanken, Decision Economics, Royal Bank of Canada, Salomon Smith Barney, Scotiabank, Shinsei Bank, Warburg Dillon Read.

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PRICES AND WAGES

Mar 8th 2001
From The Economist print edition

Japan's consumer prices edged up by 0.1% in the year to January after a 16-month slide in year-on-year inflation. Annual producer-price inflation in the euro area slowed sharply, from 5.4% in the year to December to 4.8% in the year to January. Dutch workers received a pay rise of 2.9% in the 12 months to January, a real decrease of 1.2%.

% change at annual rate	Consumer prices*		The Economist poll consumer prices forecast		Producer prices*		Wages/earnings	
	3 mths†	1 year	2001	2002	3 mths†	1 year	3 mths†	1 year
Australia	+ 1.2	+ 5.8 Q4	+ 3.9	+ 3.0	+10.2	+ 8.4 Q4	– 3.3	+ 5.0 Q4
Austria	na	+ 2.8 Jan	+ 1.7	+ 1.7	– 1.1	+ 2.6 Feb	+ 1.9	+ 2.2 Dec
Belgium	– 0.2	+ 2.3 Feb	+ 2.0	+ 1.9	+ 9.0	+ 7.1 Dec	+ 3.7	+ 1.6 Q4
Britain	+ 1.3	+ 2.7 Jan	+ 2.2	+ 2.5	+ 0.2	+ 1.9 Jan	+ 7.0	+ 4.4 Dec
Canada	+ 0.3	+ 3.0 Jan	+ 2.4	+ 2.2	+ 2.4	+ 3.1 Jan	– 3.0	+ 1.7 Dec
Denmark	+ 1.3	+ 2.3 Jan	+ 2.3	+ 2.3	– 1.0	+ 4.1 Jan	+ 7.0	+ 3.8 Q3
France	+ 0.7	+ 1.2 Jan	+ 1.4	+ 1.5	+ 0.5	+ 3.6 Jan	+ 4.6	+ 5.3 Q3
Germany	+ 2.8	+ 2.6 Feb	+ 1.7	+ 1.5	+ 0.8	+ 3.8 Jan	na	+ 2.3 Dec*
Italy	+ 3.2	+ 3.0 Feb	+ 2.2	+ 2.0	+ 4.2	+ 5.4 Jan	+ 0.9	+ 1.7 Dec*
Japan	– 0.1	+ 0.1 Jan	– 0.4	– 0.3	+ 2.7	+ 0.1 Feb	na	+ 1.8 Dec
Netherlands	+ 2.3	+ 4.2 Jan	+ 3.2	+ 2.3	+ 3.6	+ 6.8 Jan	+ 2.3	+ 2.9 Jan
Spain	+ 3.0	+ 3.7 Jan	+ 2.9	+ 2.7	+ 1.5	+ 3.9 Jan	+ 3.2	+ 2.4 Q3
Sweden	na	+ 1.7 Jan	+ 1.7	+ 1.7	+ 6.7	+ 3.7 Dec	+ 3.4	+ 2.4 Dec*
Switzerland	+ 0.4	+ 0.8 Feb	+ 1.4	+ 1.3	nil	+ 1.4 Jan	na	+ 0.2 1999
United States	+ 3.3	+ 3.7 Jan	+ 2.6	+ 2.3	+ 4.8	+ 4.8 Jan	+ 4.8	+ 3.9 Jan
Euro area	+ 1.9	+ 2.4 Jan	+ 1.9	+ 1.8	+ 2.6	+ 4.8 Jan	+ 1.2	+ 1.8 Q3
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*							
Finland	+ 0.1	+ 3.3 Jan	na	na	– 1.1	+ 4.7 Jan	+ 3.0	+ 4.3 Q4*
Greece	+ 6.6	+ 3.4 Jan	na	na	+ 8.6	+ 6.7 Dec	na	na
Iceland	+ 2.8	+ 4.1 Feb	na	na	+ 2.8	+ 4.4 Jan	+ 6.2	+ 9.3 Jan
Ireland	+ 3.0	+ 5.2 Jan	na	na	– 0.2	+ 3.8 Jan	+17.5	+ 7.0 Q2*
Luxembourg	+ 5.6	+ 2.9 Jan	na	na	+ 0.3	+ 5.0 Nov	+ 7.7	+ 8.4 Oct*
New Zealand	+ 4.7	+ 4.0 Q4	na	na	+15.0	+10.2 Q4	+ 1.8	+ 1.6 Q4
Norway	+ 4.2	+ 3.4 Jan	na	na	na	+ 3.3 Jan	+ 2.9	+ 3.8 Q3*
Portugal	+ 5.7	+ 4.4 Jan	na	na	+ 4.3	+ 7.3 Jan	na	+ 3.0 Nov*

*Not seasonally adjusted. †Average of latest 3 months compared with average of previous 3 months, at annual rate.

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MONEY AND INTEREST RATES

Mar 8th 2001
From The Economist print edition

Concerns about consumer confidence and the general economic outlook prompted Australia's central bank to cut interest rates by 0.25% on March 7th. The move followed a cut of 0.5% in February and was widely expected by the market.

	Money supply* % rise on year ago			Interest rates % p.a. (Mar 7th 2001)							
				over-	3-mth money market		banks	2-year	10-year gov't		corporate
	narrow	broad		night	latest	year ago	prime	gov't bonds	latest†	year ago	bonds
Australia	+ 9.7	+ 5.8	Jan	5.50	5.35	5.84	8.50	4.61	5.18	6.68	6.76
Britain	+ 4.2	+ 9.4	Jan	4.79	5.55	6.19	6.75	5.18	4.77	5.29	6.14
Canada	+13.7	+ 7.9	Jan	4.93	4.74	5.01	6.75	4.72	5.30	6.11	6.98
Denmark	na	+ 1.8	Dec	5.00	5.27	4.15	8.00	4.81	5.00	5.67	7.11
Japan	+ 4.7	+ 2.7	Feb	0.13	0.14	0.05	1.50	0.16	1.13	1.75	1.35§
Sweden	+ 2.4	+ 0.1	Jan	4.00	3.95	4.11	4.50	4.12	4.75	5.59	4.37
Switzerland	– 3.2	+ 0.4	Jan	3.52	3.45	2.38	5.50	3.28	3.35	3.71	4.25
United States	– 1.8	+ 9.5	Jan	5.44	4.93	5.90	8.50	4.42	4.77	6.38	6.97
Euro area‡	+ 1.4	+ 4.7	Jan	4.83	4.70	3.67	5.65	4.40	4.69	5.37	5.62

†France 4.84, Germany 4.69, Italy 5.17. Benchmarks: Japan No.229 1.35, US 30-yr 5.32. ‡Germany for prime and bonds. §New series.

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4.Sources: Commerzbank, Den Danske, J.P. Morgan Chase, Royal Bank of Canada, Svenska Handelsbanken, Warburg Dillon Read, WEFA Group, Westpac, Thomson Financial Datastream.Rates cannot be construed as banks' offers.

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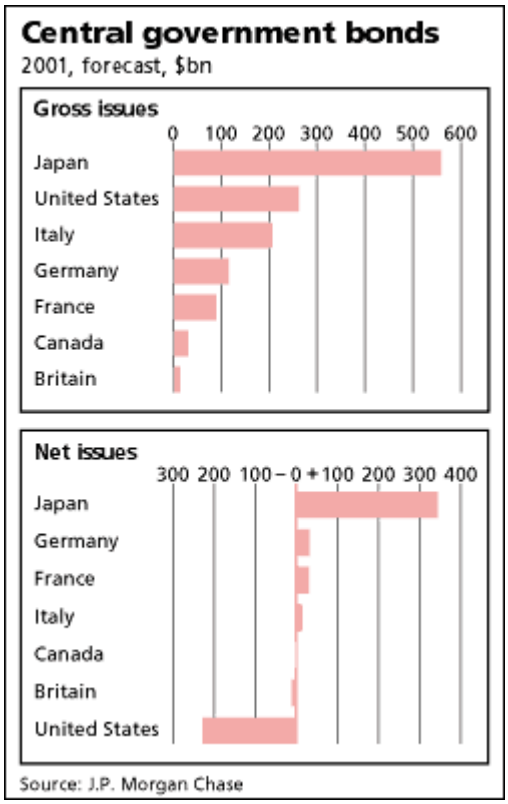
GOVERNMENT DEBT

Mar 8th 2001
From The Economist print edition

The Japanese government is expected to be the world's biggest borrower in 2001. According to forecasts by J.P. Morgan Chase, its gross borrowing will be around $560 billion, more than double that of the next biggest borrower, America. Because of its huge budget deficit, intended to stimulate its ailing economy, two-thirds of Japan's borrowing will be net new debt. In contrast, all of America's gross borrowing will be to refinance existing debt that matures this year. Thanks to its budget surplus, America will be a net repayer of debt, to the tune of more than $200 billion. On current trends, America's entire national debt will be paid off within a decade—though nobody really expects this to happen. Britain is also expected to be a net repayer of debt this year.



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TRADE, EXCHANGE RATES AND BUDGETS

Mar 8th 2001
From The Economist print edition

Australia's visible-trade deficit narrowed to $4.3 billion in the 12 months to January, and its current-account deficit shrank to $15.1 billion in the year to the fourth quarter. On March 7th the yen sank to a 20-month low against the dollar before recovering slightly; in trade-weighted terms the Japanese currency lost 2.4%.

	Trade balance*, $bn		Current account			Exchange rate		Currency units					Budget
	latest month	latest 12 months	$bn latest 12 mths	The Economist poll % of GDP, forecast 2001	2002	trade-weighted† Mar 7th	year ago	per $ Mar 7th	per $ year ago	per £	per euro	per ¥100	balance % of GDP 2000‡
Australia	+ 0.04 Jan	– 4.3	– 15.1 Q4	-3.4	-3.6	70.0	78.4	1.96	1.64	2.87	1.82	1.64	0.9
Austria	+ 0.10 Nov§	– 4.1	– 5.1 Dec	-2.4	-2.0	100.7	100.3	14.8	14.4	21.7	13.8	12.38	-1.6
Belgium	– 0.01 Nov§	+ 12.8	+ 10.3 Sep	4.2	4.2	99.5	98.9	43.5	42.2	63.6	40.3	36.3	-0.1
Britain	– 4.10 Dec	– 42.9	– 16.3 Q3	-1.9	-1.6	104.5	109.3	0.68	0.63	–	0.63	0.57	2.7
Canada	+ 3.84 Dec	+ 36.6	+ 12.7 Q4	0.6	0.9	77.2	80.9	1.55	1.46	2.27	1.44	1.29	2.5
Denmark	+ 0.39 Dec	+ 5.0	+ 2.4 Dec	1.4	1.4	102.3	101.0	8.04	7.78	11.8	7.46	6.71	2.7
France	+ 0.03 Dec	+ 1.9	+ 25.6 Nov	1.9	1.9	102.3	101.7	7.07	6.86	10.3	6.56	5.90	-1.4
Germany	+ 1.70 Dec	+ 51.6	– 29.8 Dec	-1.2	-1.0	99.4	98.6	2.11	2.04	3.08	1.96	1.76	1.4
Italy	+ 0.14 Dec	+ 1.3	– 5.3 Nov	-0.2	-0.1	73.0	72.6	2,087	2,023	3,051	1,936	1,742	-0.1
Japan	+ 6.57 Dec	+ 117.0	+ 117.7 Dec	2.3	2.3	138.8	152.3	120	107	175	111	–	-6.0
Netherlands	+ 1.92 Dec§	+ 14.6	+ 13.7 Q4	3.9	4.2	98.5	97.7	2.38	2.30	3.47	2.20	1.98	1.6
Spain	– 3.60 Dec	– 39.5	– 18.8 Nov	-3.1	-3.1	74.6	74.1	179	174	262	166	150	-0.3
Sweden	+ 1.14 Jan	+ 14.0	+ 5.5 Dec	2.1	2.0	78.1	83.0	9.74	8.83	14.2	9.04	8.13	3.4
Switzerland	+ 0.08 Jan§	– 0.9	+ 32.5 Q3	11.8	11.3	107.8	102.5	1.66	1.68	2.42	1.54	1.38	na
United States	– 39.18 Dec	– 449.5	– 416.5 Q3	-4.3	-3.9	116.4	108.6	–	–	1.46	0.93	0.83	2.3
Euro area	+ 0.63 Dec§	+ 11.2	– 26.7 Dec	-0.2	-0.2	80.3	79.7	1.08	1.05	1.58	–	0.90	0.3
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*												
Finland	+ 1.13 Dec§	+ 13.2	+ 9.2 Dec	na	na	78.6	77.1	6.46	6.21	9.44	5.99	5.39	4.0
Greece	– 1.80 Q3	– 7.2	– 7.6 Sep	na	na	57.7	58.6	371	348	542	344	310	-1.0
Iceland	+ 0.01 Jan§	– 0.5	– 0.7 Q2	na	na	na	na	86.0	74.3	126	79.8	71.8	2.8
Ireland	+ 2.66 Nov	+ 25.9	+ 0.2 Q3	na	na	88.5	87.0	1.17	0.82	1.70	1.08	0.97	5.6
Luxembourg	– 0.19 Nov	– 2.5	+ 1.6 Q3	na	na	99.5	98.9	43.9	42.2	64.2	40.7	36.7	na
New Zealand	+ 0.04 Jan§	– 0.6	– 3.3 Q3	na	na	79.8	84.4	2.33	2.05	3.41	2.16	1.94	0.5
Norway	+ 2.47 Jan	+ 26.0	+ 22.2 Dec	na	na	93.6	93.3	8.94	8.45	13.1	8.29	7.46	14.0
Portugal	– 1.10 Nov§	– 14.8	– 11.0 Nov	na	na	89.8	89.1	218	209	319	203	182	-1.5

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †1990=100, Bank of England. ‡OECD estimate.
§Not seasonally adjusted.

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STOCKMARKETS

Mar 8th 2001
From The Economist print edition

The three American indices gained ground as investors hoped the markets had fallen enough to reflect worsening prospects for earnings. London rose too. The Nikkei 225 rebounded by 3.0% on March 6th, but ended the week 1.2% lower.

Market indices	Mar 7th	2001 high	2001 low	% change on one week	% change on one year	% change on record high	% change on Dec 31st 2000 in local currency	% change on Dec 31st 2000 in $ terms
Australia (All Ordinaries)	3,306.2	3,312.1	3,154.7	+ 1.0	+ 2.7	– 0.7	+ 4.8	– 3.8
Austria (ATX)	1,219.5	1,219.5	1,052.2	+ 1.8	+ 16.0	– 29.8	+ 13.6	+ 12.3
Belgium (Bel 20)	2,984.7	3,030.4	2,952.8	– 0.5	+ 11.0	– 18.9	– 1.3	– 2.5
Britain (FTSE 100)	6,001.8	6,334.5	5,858.6	+ 1.4	– 6.4	– 13.4	– 3.5	– 5.6
Canada (Toronto Composite)	8,301.8	9,348.4	8,006.9	+ 2.8	– 10.6	– 27.1	– 7.1	– 9.9
Denmark (Copenhagen SE)	934.9	1,002.1	906.8	– 0.4	+ 8.7	– 10.0	+ 3.1	+ 1.9
France (SBF 250)	3,541.0	3,820.2	3,423.1	+ 2.0	– 13.4	– 19.4	– 6.1	– 7.2
Germany (Xetra DAX)	6,305.6	6,795.1	6,075.3	+ 1.6	– 21.1	– 21.8	– 2.0	– 3.1
Italy (BCI)	1,750.1	1,948.4	1,714.4	– 1.4	– 18.1	– 19.8	– 8.7	– 9.7
Japan (Nikkei 225)	12,723.9	14,032.4	12,261.8	– 1.2	– 35.6	– 67.3	– 7.7	– 12.0
(Topix)	1,236.1	1,313.0	1,193.7	– 0.4	– 25.6	– 57.1	– 3.7	– 8.2
Netherlands (EOE)	598.3	642.3	585.3	+ 0.2	– 11.3	– 14.7	– 6.2	– 7.3
Spain (Madrid SE)	941.0	963.9	878.6	+ 3.7	– 17.1	– 17.9	+ 6.9	+ 5.6
Sweden (Affarsvarlden Gen)	268.6§	292.7§	252.6§	+ 3.4	– 30.2	– 32.8	– 3.2	– 6.2
Switzerland (Swiss Market)	7,605.2	8,135.4	7,533.5	– 1.3	+ 9.5	– 9.6	– 6.5	– 8.6
United States (DJIA)	10,729.6	10,983.6	10,441.9	+ 2.2	+ 8.9	– 8.5	– 0.5	– 0.5
(S&P 500)	1,261.8	1,373.7	1,234.2	+ 2.0	– 7.7	– 17.4	– 4.4	– 4.4
(Nasdaq Comp)	2,223.9	2,859.2	625.2	+ 3.4	– 54.6	– 55.9	– 10.0	– 10.0
Europe (FTSE Eurotop 300) *	1,447.5	1,545.5	1,414.8	+ 1.3	– 10.8	– 15.1	– 5.6	– 6.7
Euro area (FTSE Ebloc 100) *	1,300.2	1,404.1	1,255.1	+ 1.7	– 12.7	– 34.4	– 6.6	– 7.7
World (MSCI) †	1,152.0**	1,249.2	1,130.2	+ 1.2	– 14.9	– 20.5	na	– 6.2
World bond market (Salomon) ‡	443.6	447.8	437.7	+ 0.1	+ 3.6	– 3.6	na	– 0.1

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms.
‡Salomon Smith Barney World Government Bond Index, total return, in dollar terms. §Rebased. **Provisional.

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RISKY ECONOMIES

Mar 8th 2001
From The Economist print edition

Every quarter the Economist Intelligence Unit, a sister company of *The Economist*, assesses the riskiness of investing in 100 countries. The EIU's criteria include a country's political structure, economic policies, sovereign-debt risk and the state of its banking system. Scores can range from zero (negligible risk) to 100 (maximum risk). Most countries' riskiness dropped during 2000, with oil exporters faring especially well in the fourth quarter: Russia's risk rating fell from 63 to 59, and Oman's from 42 to 35. However, the EIU notes that reverberations from America's economic slowdown could be reversing this trend in the first quarter of 2001. According to the firm's analysts, Asia and Latin America are most vulnerable to damage from a hard landing in the America.

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FINANCIAL MARKETS

Mar 8th 2001
From The Economist print edition

Hong Kong lost 1.0% on March 7th after the government's budget failed to provide measures to boost the property market; it finished the week 4.1% lower. Tel Aviv fell by 2.2% during the week on worries about the new Israeli government. Buenos Aires soared by 9.9%, cheered by the appointment of a new economy minister.

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Mar 7th		Dec 31st 2000	
	Mar 7th	year ago	Mar 7th	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	12.1	5.40	2,095.6	+ 1.3	− 4.4	− 4.4
Hong Kong	7.80	7.78	11.4	4.95	14,177.4	− 4.1	− 6.1	− 6.1
India	46.5	43.6	68.0	8.33	4,046.9	− 4.7	+ 1.9	+ 2.3
Indonesia	9,875	7,440	14,435	15.05	430.6	+ 0.5	+ 3.4	+ 1.3
Malaysia	3.80	3.80	5.55	3.30	701.7	− 1.1	+ 3.2	+ 3.2
Philippines	48.1	41.1	70.3	12.19	1,603.9	− 0.6	+ 7.3	+ 11.5
Singapore	1.76	1.71	2.57	1.94	1,910.7	− 1.9	− 0.8	− 2.2
South Korea	1,270	1,119	1,856	5.68	568.6	− 1.6	+ 12.7	+ 12.3
Taiwan	32.4	30.7	47.3	4.95	5,777.1	+ 1.8	+ 21.8	+ 24.5
Thailand	43.7	37.9	63.8	2.75	306.4	− 5.8	+ 13.8	+ 13.1
Argentina	1.00	1.00	1.46	6.56	479.0	+ 9.9	+ 14.9	+ 14.7
Brazil	2.05	1.76	2.99	15.11	16,395.2	+ 3.0	+ 5.1	+ 0.1
Chile	587	508	858	3.88*	5,001.8	+ 1.8	+ 2.7	+ 0.4
Colombia	2,263	1,958	3,308	13.29	830.4	+ 0.8	+ 16.5	+ 15.1
Mexico	9.66	9.26	14.1	15.89	6,331.3	+ 5.0	+ 12.0	+ 11.4
Peru	3.51	3.40	5.1	10.77	1,285.3	− 0.5	+ 6.4	+ 6.7
Venezuela	705	664	1,031	13.94	7,905.3	+ 2.2	+ 16.4	+ 15.4
Egypt	3.88	3.44	5.66	9.09	6,911.8	+ 3.5	− 9.8	− 9.4
Israel	4.12	4.00	6.03	5.51	439.6	− 2.2	− 11.1	− 12.8
South Africa	7.89	6.49	11.5	10.45	9,127.7	+ 1.3	+ 9.6	+ 5.2
Turkey	905,000	579,195	1,322,929	52.00	9,513.8‡	+ 8.2	+ 0.8	− 25.3
Czech Republic	37.5	37.1	54.9	5.06	471.9	+ 3.9	− 1.4	− 1.1
Hungary	287	268	420	11.13	7,233.3	+ 1.6	− 7.9	− 9.4
Poland	3.96	4.13	5.79	18.13	15,427.1	− 0.3	− 13.6	− 9.9
Russia	28.7	28.6	41.9	25.00	180.5†	+ 9.5	+ 26.1	+ 26.0

*Inflation adjusted. †In dollar terms. ‡March 2nd.

Sources: National statistics offices, central banks and stock exchanges; Primark Datastream; EIU; Reuters; Warburg Dillon Read; J.P. Morgan; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Bank Ekspres; Deutsche Bank; *Russian Economic Trends*.

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ECONOMY

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Hong Kong's GDP growth slowed to 6.8% in the year to the fourth quarter; total growth for 2000 as a whole was 10.5%. Hungary's GDP growth slipped to 4.2% in the year to the fourth quarter, although the growth rate of 5.3% for the whole year was still its fastest for a decade. Venezuela's 12-month inflation rate was 12.7% in February, down from 17.9% a year earlier.

	% change on year earlier			Latest 12 months, $bn		Foreign reserves*, $bn	
	GDP	Industrial production	Consumer prices	Trade balance	Current account	Latest	Year ago
China	+ 7.3 Q4	+ 2.3 Jan	+ 1.5 Jan**	+24.0 Jan	+15.7 1999	168.3 Dec	157.7
Hong Kong	+ 6.8 Q4	− 0.1 Q3	− 1.2 Jan	−10.4 Jan	+ 9.4 Q3	114.3 Feb	93.1
India	+ 5.9 Q1	+ 3.4 Dec	+ 3.2 Jan	− 7.8 Jan	− 5.6 Q3	38.1 Jan	32.6
Indonesia	+ 5.2 Q4	+38.4 Q4†	+ 9.1 Feb	+28.3 Dec	+ 6.1 Q1	22.6 Dec	26.5
Malaysia	+ 6.5 Q4	+12.5 Jan	+ 1.5 Jan	+16.0 Dec	+ 9.7 Q3	29.1 Jan	32.2
Philippines	+ 4.8 Q3	+ 8.6 Dec	+ 6.7 Feb	+ 6.7 Dec	+ 8.2 Nov	13.1 Dec	13.2
Singapore	+10.5 Q4	− 9.9 Jan	+ 2.0 Jan	+ 3.3 Dec	+21.8 Q4	80.1 Dec	76.8
South Korea	+ 9.2 Q3	+ 0.1 Jan	+ 4.2 Feb	+12.9 Feb	+11.0 Dec	95.4 Jan	76.7
Taiwan	+ 4.1 Q4	− 3.3 Jan	− 1.0 Feb	+ 9.1 Feb	+ 9.6 Q4	106.7 Dec	106.2
Thailand	+ 2.6 Q3	+ 3.5 Jan	+ 1.5 Feb	+ 4.0 Jan	+ 7.8 Jan	32.2 Jan	31.9
Argentina	nil Q3	− 2.0 Jan	− 1.5 Jan	+ 1.1 Dec	−10.5 Q3	25.2 Dec	26.3
Brazil	+ 4.4 Q4	+ 7.5 Dec	+ 5.4 Jan	− 1.1 Feb	−26.0 Jan	32.5 Dec	34.8
Chile	+ 5.8 Q3	− 2.3 Jan	+ 3.8 Feb	+ 1.5 Jan	− 1.0 Q4	14.7 Dec	14.4
Colombia	+ 2.1 Q4	+ 0.2 Dec	+ 8.1 Feb	+ 2.3 Dec	+ 0.1 Q2	8.1 Dec	7.6
Mexico	+ 5.1 Q4	− 0.4 Dec	+ 8.1 Jan	− 8.7 Jan	−17.7 Q4	39.4 Jan	33.6
Peru	− 1.6 Jan	− 5.1 Dec	+ 3.6 Feb	− 0.3 Dec	− 1.6 Q3	8.5 Nov	8.9
Venezuela	+ 3.3 Q3	na	+ 12.7 Feb	+ 6.6 Oct	+13.4 Q4	13.1 Dec	12.3
Egypt	+ 6.5 2000‡	+ 9.4 2000‡	+ 2.4 Nov	−10.8 Q3	− 0.9 Q3	13.1 Nov	15.0
Israel	+ 3.0 Q4	+ 2.3 Dec	− 0.1 Jan	− 6.9 Jan	− 0.7 Q3	23.2 Jan	22.1
South Africa	+ 3.3 Q4	+ 4.1 Dec	+ 7.1 Jan	+ 3.4 Jan	− 0.7 Q3	6.1 Dec	6.4
Turkey	+ 7.4 Q3	+ 6.5 Jan	+ 33.4 Feb	−26.5 Dec	− 9.8 Dec	20.0 Dec	23.3
Czech Republic	+ 2.2 Q3	+ 1.4 Dec	+ 4.0 Feb	− 3.4 Jan	− 1.9 Q3	13.0 Jan	12.8
Hungary	+ 4.2 Q4	+ 7.4 Jan	+ 10.1 Jan	− 2.6 Jan	− 1.9 Jan	10.8 Jan	11.2
Poland	+ 2.2 Q4	+10.1 Jan	+ 7.4 Jan	−11.0 Jan	− 9.8 Jan	25.3 Dec	24.5
Russia	+ 7.9 Q4	+ 5.3 Jan	+ 22.3 Feb	+61.0 Dec	+43.8 Q3	25.9 Jan	8.9
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*						
Pakistan	+ 3.9 1999‡	+ 4.6 Jul	+ 4.9 Nov	− 1.9 Jan	− 2.5 1999	1.2 Dec	1.5
Saudi Arabia	+ 0.4 1999	na	− 1.0 Nov	+24.9 1999	− 1.7 1999	16.7 Nov	14.1

*Excluding gold, except Singapore; IMF definition. †1999. ‡Year ending June. **New series

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